A Study on the Appropriateness for Adopting 'Universal' Definitions for Tax Compliance and Non-Compliance: A New Zealand Case Study Approach

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Abstract

Issues and problems associated with the seriousness of tax non-compliance have increased dramatically over the years due to the widening tax gaps experienced by governments worldwide as a result of sophisticated transactions. To add to the severity of the situation are the concerns surrounding the difficulties associated with our abilities in defining what is meant by tax compliance, non-compliance and their relevant sub-categories. This study reviews both the international existing literature and New Zealand case law to examine how the concepts have (or have not) been defined over the years within particular studies and case law. The results are presented in the form of a critical literature review where the definitions (or descriptions) for the concepts are organized into tables, in order to compare how the definitions have (or have not) been 'improved' over the years. Lastly, this study discusses the implications regarding whether 'universal' definitions can or should be developed and attributed to each of the concepts in order to clear the murkiness between our understanding of the various concepts of tax compliance, non-compliance, and their sub-categories.

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1.0 Introduction

1.1 Background to the Topic

Debate regarding tax compliance and non-compliance is a never-ending matter. This is largely due to governments relying to a significant degree on the collection of taxes from taxpayers to achieve their goals and objectives. With the 'actual' tax liability of taxpayers usually somewhat different from what taxpayers actually declare and pay, governments are unwillingly experiencing a widened tax gap (Reckers et al., 1994; James and Alley, 1999; Richardson and Sawyer, 2001; and Manly et al., 2005).

A decade or so ago, the level of annual unpaid taxes in New Zealand remained at a fairly low percentage of the gross domestic product (GDP), estimated at around 2 to 4 percent (Tan, 1998). However, the level of unpaid taxes more recently has increased to approximately 10 to 12 percent of GDP (Business NZ, 2004) as taxpayers are becoming more 'actively' involved in non-compliant activities. Although some commentators (for example: see McBarnet, 2003 and Picciotto, 2007) hold the view that the level of compliance can be improved through the adoption of policies and regulations by either the use of clear language or the application of "precise or specific rules rather than more abstract general principles" (Picciotto, 2007, p. 12), it is not as easily seen in practice as in theory without practical problems.

Across the Tasman, Australia's Government is equally committed to adopting a series of policies and regulations to increase the compliance rate from its taxpayers. Since the early 1970s, taxpayers have become more involved in "taking advantage of many structural loopholes in the taxation laws to minimise tax" (Xynas, 2010, p. 1). In 1985, the amount of revenue losses as a result of tax avoidance and evasion schemes has been estimated to be

around $3 billion[1] per year (Xynas, 2010). Because of the significant amount of taxes that are uncollectable, the Australian Government has allocated an annual budget of around $1 billion (Australian Taxation Office, 2011) to combat this deteriorating situation. But regardless of the initiatives implemented by the Government, it is impractical to assume that the (voluntary) compliance rate will ever be at 100 percent, as some taxpayers are risk-seeking where they challenge the tax laws and loopholes to minimize their true tax liabilities.

From the figures released on the United States Internal Revenue Service (IRS) website (IRS, 2006), the gross tax gap in the United States in 2001 is estimated to be around $US345 billion (IRS, 2006), and represents a non-compliance rate of around 16 percent (U.S. Department of the Treasury, 2009).[2] This is a significant increase from the estimated figure of around US$170 billion in 1993 (Hasseldine and Li, 1999). A significant proportion of the tax gap in the United States is the result of offshore tax evasion activities where it produces an estimated $100 billion in unpaid taxes annually (Wolfe, 2008). The United States' Government has a number of initiatives[3] implemented with the objective to combat the seriousness of the non-compliance (predominantly tax avoidance and tax evasion) problem. However, the tax evasion problem is still widespread and a continuous 'threat' to the government in terms of how much tax revenue they can collect from their taxpayers.

[1] This figure has not been adjusted for inflation. Should the value have been adjusted, the $3 billion in 1985 would be equal to approximately $6.3 billion in 2011 (http://www.coinnews.net/tools/cpi-inflation-calculator/).
[2] However, after accounting for enforcement efforts and late payments, the amount of the tax gap is reduced to $290 billion, and represents a non-compliance rate of around 13.7 percent (U.S. Department of the Treasury, 2009).
[3] For a comprehensive list of the initiatives and proposals, please see: "Update on reducing the federal tax gap and improving voluntary compliance," a document drafted by the United States Department of the Treasury (2009).

It is interesting to note that, from the document drafted by the U.S. Department of the Treasury (2009), they do not view the term 'tax gap' as a synonymous for the 'underground economy'[4] because the amount of the gross tax gap may not necessarily be the result of non-compliance in the form of tax avoidance or tax evasion. Examples of possible 'innocent' reasons for not complying with the tax regulation such as, confusion, carelessness or errors of ignorance may also contribute to the growing tax gap (U.S. Department of the Treasury, 2009). But undeniably, a significant proportion of the tax gap is highly likely to be the result of non-compliant activities, and this leads to "sizeable budgetary implications, and implications for taxation incidence and income distribution" (Giles, 1999, p. 2).

Apart from the instant revenue loss experienced by the government, other unavoidable negative effects of the tax gap as a result of non-compliant activities include, "[the] growing disrespect for the tax system and the law, increasing complex tax legislation, the uneconomic allocation of resources, an unfair shifting of the tax burden and a weakening of the ability of Parliament and National Treasury to set and implement economic policy" (South African Revenue Service, p. 9). These impacts will, as a result, affect the "efficiency and equity of [the] tax systems" (Evans, 2007, p. 6), and possibly to the overall function of a country's economy.

Contributing to the growing tax gap as a consequence of more taxpayers being actively engaged in non-compliant activities has been an increase in more taxpayers being 'targeted' by revenue authorities, where they are likely to face either penalties or imprisonment (depending on the severity and legality of the issue) imposed by the Judiciary. Over the years, case law has dealt with a growing number of (similar) situations where taxpayers have either challenged or contravened the relevant legislation, either intentionally

[4] Within this thesis, the 'underground economy' is broadly viewed as the total value of goods and services produced, but without official measurement by the country that produced them (U.S. Department of the Treasury, 2009).

or without the requisite knowledge. As a result, a variety of different approaches and principles have been adopted through existing literature and particularly case law in an attempt to define and determine what actions are to be constituted as tax compliance and tax non-compliance behaviours.

However, the highly complex tax environment has impeded the search for harmonized definitions for tax compliance, non-compliance and their relevant sub-categories. The last decade in New Zealand alone has seen a number of significant cases[5] associated closely with either tax avoidance or tax evasion behaviour. The judgments of the cases appear to be placing an importance on the substance and form of the transaction at issue first, before adopting various approaches and relevant legislations in order to determine the outcome of the particular case. During the process of reaching the decision outcome for a particular case, the courts also consider previous cases that are of a similar nature to act as 'precedents' for the case at issue. However, the problem arises when different approaches are adopted by the Judiciary, making it difficult for taxpayers to fully understand objectively what is deemed to be acceptable behaviour and what is not.

Nevertheless, these cases have enhanced our general understanding for behavioural tax compliance and non-compliance, by way of example, but clearly, there is still scope for more research to be conducted due to the changes in taxpayer behaviours and the need to adopt 'universal' definitions for the major terms concerned with tax compliance and non-compliance. However, this desired outcome may be difficult because of the various 'approaches' adopted by the Judiciary to determine the nature of the tax issue, in that they cannot be compressed into one solid approach due to the complexity of the facts and the nature of the activities involved in the individual cases. As a result, this study will also look

[5]Cases such as *Ben Nevis* ("Trinity") and *Penny & Hooper* can be viewed as representations of recent tax avoidance related cases in New Zealand, as will be discussed in more detail in Chapter 3: Literature Review-New Zealand Case Law and Tax Compliance.

at the appropriateness of having various approaches when determining the outcome of case law, as well as attempting to place a 'universal' definition for the key concepts of tax compliance and non-compliance.

Therefore, this study focuses predominantly on two main areas, namely, existing literature and case law. Through the research on existing literature and case law, this study sets out to examine whether it is feasible to draw comparisons between how the key terms are understood and comprehended, as well as examining whether problems (or conflicts) may arise if the definitions for the concepts are becoming more consistent. In addition, this study will examine possible relationships between existing studies and case law, and assess whether 'universal' definitions can (or should) be established for the terms associated with tax compliance, non-compliance and their sub-categories.

1.2 Importance of the Topic

Over the years, the number of studies and case law within the area of tax compliance and non-compliance has increased dramatically due to the substantial rise in the level of uncollected taxes by governments. With the number of existing studies and case law, one would assume that the definitions for the concepts of tax compliance and non-compliance would be defined clearly, and that any ambiguities with the concepts would have been eliminated (or at least reduced). Unfortunately, this has not (yet) been achieved. However, there is a common understanding that tax compliance refers to taxpayers who pay their share of tax liabilities, whereas, non-compliance refers to taxpayers who don't and, tax avoidance is legal and tax evasion is illegal. But 'comprehensive' definitions for each of these concepts have yet to be established across studies (in particular) and case law, largely because of the reason that "tax has the reputation of being a complex subject" (Richardson, 1967, p. 6). Therefore, throughout this study, the difficulties in attempting to establish a 'universal'

definition for tax compliance and non-compliance in both areas, especially in case law scenarios where the facts of each case are bound to be different, will be examined closely.

A further complication arises as a result of the emphasis of most studies focusing predominantly on what variables influence the behaviours of tax compliance and non-compliance, rather than placing a greater importance on what the concepts mean and categorising what kind of taxpayer behaviours may constitute as being either compliance or non-compliance. Changes affecting taxpayers' willingness to cooperate may be divided between external and internal variables. External variables have generally included the examination of changes in the tax rate and the probability of audits, as well as studies conducted from economics' perspective. On the other hand, psychological studies have focused on internal variables, such as, taxpayers' knowledge and their attitude towards the tax system. Although the study of these variables enhance our understanding on the overall topic of behavioural tax compliance, a shift in the focus of study may further enhance the value output of a particular study in the future.

Adding to the complexity of the topic are recent issues such as self-assessment opportunities, the emergence of a more global economy, and the complexity and sophistication of commercial transactions (Simser, 2008). Above that, more and more existing studies have seen the importance of distinguishing between 'layers' of compliance, and 'sub-categories' of non-compliance. However, the ability to differentiate objectively between the 'layers' and 'sub-categories' of tax compliance and non-compliance remains questionable, especially in circumstances where researchers have different approaches towards understanding a particular concept, and therefore, how the concept is categorised by the researcher of that particular study. These problems add to the difficulties of the Inland Revenue Department (IRD) or similar organizations, to determine appropriate penalty levels and the categorization of compliance and non-compliance behaviours demonstrated by

taxpayers. Not only will it be the IRD (or similar organizations) who experience the difficulties and challenges associated with the issue, but it is also important to consider the problem from the perspective of taxpayers and practitioners who are closely related to the various tax issues (either directly or indirectly). In addition, it is also important to consider those who may be 'exposed' to civil and/or criminal penalties and punishments if there is no clear (or clearer) distinction between the concepts of tax compliance, non-compliance and the relevant sub-categories.

As for case law, the difficulty associated with the establishment of universal definitions lie in the variety of possible legislative forms of non-compliance, as well as the uniqueness and individuality of the facts associated with each of the cases. Although it is possible to come across two cases with extremely similar circumstances, the similarity in the facts presented to courts cannot be treated as an 'easy' method to determine the outcome of a particular case (although preceding case does influence the treatment of the latter case, to an extent). Furthermore, the nature and type of non-compliant activities at issue for each individual case also raise difficulties in attempting to establish universal definitions for the concepts at issue.

Since there are no predetermined definitions for the concepts of tax compliance and non-compliance, the decision and outcome of the each case is the result of studying similar cases by drawing similarities and differences (by way of precedent) through the relevant approaches and principles. Therefore, by studying relevant case law, some possible similarities may become apparent as to how the understandings of tax compliance and non-compliance have been articulated under different scenarios, and whether a pattern of use for the relevant concepts can be formed to establish universal definitions for tax compliance and non-compliance.

1.3 Objectives of the Study

Before embarking onto the focus of the study, it is necessary to determine what the concepts of tax compliance and non-compliance represent within this study. The starting point for the concept of tax compliance would be to incorporate the well-established definition adopted by the Inland Revenue Service (IRS) where taxpayers file "accurate, timely, and fully paid return without IRS enforcement efforts" (Jackson and Milliron, 1986, p. 130). On the other hand, tax non-compliance is intended to convey the notion where it is the opposite of tax compliance, where taxpayers may be engaged in various schemes (either intentionally or unintentionally), and involving themselves in either: tax avoidance, tax evasion, and ultimately, over-compliance activities and behaviours. The effects of tax compliance, non-compliance and their sub-categories will be considered in more depth in the following chapters, through the examination of two broad areas, namely: the current behavioural tax literature and case law.

There are three main objectives for this study. First, this study focuses on the issues and problems surrounding what are meant by tax compliance and non-compliance. This study also explores whether existing confusion between these two main concepts can be reduced to some extent in order to enhance the comparability and understandability of future studies within this area.

Second, this study looks at whether the definitions on each of the concepts of tax compliance, non-compliance and their sub-categories can be defined and organized into distinct groups after reviewing relevant literature from existing research studies and case law. Aligned with the second objective is the need to detect whether the definitions and understandings of the concepts are comparable between existing literature and case law.

Third, this study will attempt to develop a 'universal' definition that can be applied to each of the concepts when combining the results from existing research and case law, and look at the potential problems that may exist as a result of higher uniformity in the definitions. It will also consider any problems that may arise if definitions cannot be made more consistent within specific the area of behavioural tax compliance and non-compliance.

Therefore, based on the objectives of this study, the research question is formally stated as:

"Whether the issues and problems of tax compliance, non-compliance and their relevant sub-categories can be reduced to an extent in both existing literature and case law if a 'universal' definition is to be attributed to each of the associated concepts?"

The remainder of this study is organized as follows: First, a brief summary of what existing international tax behavioural research and recent case law from New Zealand have found is presented in the form of a detailed literature review in Chapters 2 and 3, respectively. Second, the proposed research methods for this study are described in Chapter 4. Third, the research results are presented in the form of a critical review of international literature and New Zealand case law in Chapters 5 and 6, respectively. Fourth, a discussion on the research results, as well as the contributions of this study is analyzed in Chapter 7. Finally, the conclusions, key limitations and potential areas for future research are outlined in Chapter 8.

2.0 Literature Review- Behavioural Tax Compliance

2.1. Introduction

Based on the objectives for this study, two broad areas, namely, existing tax behavioural literature and case law, relating to behavioural tax compliance and non-compliance, will be examined in detail. As noted earlier, taxation can be perceived as a "complex phenomenon" (Franzoni, 2000, p. 52) where it may be impossible to define the concepts of tax compliance, non-compliance, and their sub-categories objectively. For example, Anderson (1993) emphasizes the challenge to measure tax evasion in an 'agreed' way between studies due to the various factors that may influence how one understand and apply the concepts. This is evident from Anderson's (1993, p. 186) study where he believes that, "what is perceived to be an acceptable level of compliance at one time may not be acceptable at another [time]."

In addition, it is plausible that the definitions for tax compliance and non-compliance may be addressed from a variety of perspectives, which then further complicates the problem for taxpayers and researchers to understand the concepts fully. The complexity of the problem within tax compliance is mainly separated by whether compliance is voluntary or enforced, and whether taxpayers are acknowledging both the 'spirit' and 'letter' of the law'. This is known in this study as the various 'layers' of tax compliance. On the other hand, non-compliance problems are predominantly associated with its sub-categories, such as, the existence of sub-categories such as: tax avoidance, tax evasion, and over-compliance. However, the common theme between tax compliance and non-compliance is the issue of whether a particular behaviour is 'intentional' or 'unintentional'. This distinction raises another level of difficulty for understanding the concepts, but yet, an important aspect to

consider, as not all taxpayer activities resulting to non-compliance are intentional and not all compliant behaviours were intended by the taxpayers. The chapter will now begin its analysis on the area of tax compliance and non-compliance.

2.2 Tax Compliance

Under the main category of tax compliance underlies an important behaviour demonstrated by a majority of taxpayers to reduce their tax liabilities legally. This is commonly known as legitimate tax planning (or tax minimisation), where there are two main objectives for it. The first objective is to; of course, reduce the tax payable by the taxpayer, while the second objective is to defer the payment of tax liabilities due. Undoubtedly, there is a difficult line to draw between tax planning (which is perfectly legitimate and acceptable) and tax avoidance (legal but unacceptable). In addition to the difference between tax planning and tax avoidance, the term 'aggressive tax planning' was introduced in the study by Murphy (2004, p. 307), where she defines the concept as when taxpayers are "finding ways to accomplish compliance with the letter of the law while totally undermining the policy intent or spirit behind the words."

In addition, tax planning behaviour involves taxpayers finding ways to "exploit deficiencies or uncertainty in the law…" (Murphy, 2004, p. 307). This definition, along with other tax compliance definitions introduced later, shares similar characteristics with the definitions that separate out compliance with the 'letter' of the law and compliance with the 'spirit' of the law. The term 'tax mitigation' has also been occurring in studies (for example: see Sawyer, 1996 and Evans, 2007), where it is treated in a similar manner as tax planning. This variation in how the concepts are understood may be due to how different countries treat the terms, depending on how 'accommodative' they are for each of the main tax terms. However, caution must be made to the extent of tax minimization techniques employed by

the taxpayers that they do not cross to the (blurred) line of (unacceptable) tax avoidance behaviour.

Therefore, since tax planning, tax mitigation, and aggressive tax planning appear to be other approaches for understanding the layers of tax compliance, this study will exam tax compliance from another perspective (as described below) to allow for a more generic, yet, representative analysis of what behaviours can be incorporated under the main branch of tax compliance.

As a result, for the section on tax compliance, this study has set out to examine the distinction between compliance with the letter/spirit of the law and whether compliance is voluntary/enforced, rather than clearing the confusion on how the concepts are understood by individuals as the distinction between them are difficult and impractical to make within this complicated area of study.

2.2.1 The definitions of tax compliance

The concept of tax compliance may be explored through several possible dimensions, with each one varying slightly according to the perspectives of the researchers and how each study was conducted (Kirchler, 2007). From an online blog by Murphy (2010), the definition for tax compliance has been described as when taxpayers seek "to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the pace and form in which they are reported for taxation purposes." This definition is fairly descriptive of the kind of behaviours that would be viewed as tax compliance, and interestingly, this definition is incredibly similar to the definition used by the Inland Revenue Service (IRS), where the IRS defines tax compliance as, "when the taxpayer files all required tax returns at the proper time and that the returns accurately report tax in accordance with the Inland Revenue Code, regulations and

court decisions applicable at the time the return is filed" (Hasseldine and Li, 1999, p. 92). This definition is probably one of the most comprehensive present in existing literature. It takes into account the time and rules that are involved when a taxpayer files their tax returns; however, it is still not enough to cover all the possible taxpayer behaviours. This definition does not take into account the reasons behind why taxpayers comply. For example, Ratto et al. (2005, p. 3) believe tax compliance may be:

> "*Influenced by opportunities to evade and personal circumstances that may impact on the cost of compliance, by people's perceptions of how they are treated by the tax authority and their perceptions of the enforcement system and also by interactions with other taxpayers.*"

This assumption coincides to a certain degree with the IRS's definition in that it does not take into account "taxpayers' motivation regarding tax compliance" (Hasseldine & Li, 1999, p. 3). Therefore, tax compliance arguably has a wider scope than what was proposed by Ratto et al. (2005), as it can include "taxpayers who voluntarily comply with the tax law and taxpayers who comply as a result of enforcement activities" (Kirchler, 2007, p. 22). Therefore, taxpayers who 'voluntarily comply' will be those taxpayers who pay their tax liabilities without direct the IRS's [or equivalent] intervention (U.S. Department of the Treasury, 2009), while the opposite occurs when taxpayers are enforced by law to comply with their tax obligations (to avoid penalties). The significant determinants to date for taxpayers to comply willingly include factors such as political, socio-psychological/tax morale, decision making, self-employment, and interactions between tax authorities and taxpayers (Kirchler, 2007; Torgler, 2007; and Ho and Wong, 2008). Also, the variables examined by Jackson and Milliron (1986) contribute as factors that can determine a taxpayer's compliance attitudes. However, the impacts of those variables are outside the scope of this study.

In general, the level of tax compliance by taxpayers is partially attributable to the nature of the government and the structure of the tax system (Hasseldine and Li, 1999). Nevertheless, James and Alley (1999) propose that common definitions of tax compliance are "too narrow" as the "degree of compliance varies" (Kirchler, 2007, p. 21), depending on whether compliance is being referred to as "voluntary or compulsory behaviour" (James and Alley, 1999, p. 3). James and Alley (2006, p. 5) define 'degrees' of compliance as recognizing "a basic difference in terms of compliance between [the] tax paid without direct enforcement activity and [the] tax paid as a result of it."

In addition, a definition for voluntary compliance was given as taxpayers meeting their tax obligations "without the need for enquiries, obtrusive investigations, reminders or the threat or application of legal or administrative sanctions" (James & Alley, 2006, p. 5). This definition is again very similar to the one adopted by the IRS, where they recognized voluntary tax compliance as, "a system of compliance that relies on individual citizens to report their income freely and voluntarily, calculate their tax liability correctly, and file a tax return on time" (Perez, 2011c). Within Perez's web page, the concept of voluntary tax compliance is understood to be that, you (as a taxpayer) must "tell the IRS what your liability is. And the only way to do that is to file a tax return" (Perez, 2011c).[6] However, a tax return is not always easy to file, especially for taxpayers without a reasonable level of knowledge of the tax system. This is evident from the words used in the tax guides and pamphlets where the wording is either too complicated or highly subjective, depending on how a taxpayer comprehends a particular word/sentence.[7]

[6] The need to file a tax return may differ from country to country depending on, for example, a taxpayer's source of income.

[7] For example, the tax guide prepared by the Inland Revenue Department (IRD) for taxpayers filing an IR3 contains several sentences containing the words 'if' and 'or', where it may raise confusion as to how a taxpayer would answer a particular question.

2.2.2 A 'universal' definition for tax compliance?

Although a number of studies clearly describe the concept of tax compliance and how it is applied in studies, a surprisingly large number of studies fail to do so (Richardson and Sawyer, 2001). Some studies (for example: see James et al., 2001; Wenzel, 2004; Gilligan and Richardson, 2005; Ratto et al., 2005; Ho and Wong, 2008; Kirchler et al., 2008; and Kastlunger et al., 2010) use various theories from psychology or econometric domains to explore the concept of tax compliance and what should be taken into consideration, but they do not define explicitly the concept of tax compliance. There are also some studies that assume what tax compliance is without giving a comparison of what other studies consider to be tax compliance (Kirchler et al., 2008). This approach is likely to trigger confusion as to what tax compliance behaviour is comprised of due to the ambiguous and dissimilar definitions arising from different studies.

As distinct from clearly defining or not defining tax compliance, Kastlunger et al. (2010, p. 2) studied tax compliance through adopting different approaches, describing that "there is the economic based [approach] on rational choice theory…[and] there is a socio-psychological approach where tax compliance is seen as determined by psychological factors…" In addition, James and Alley (2002, p. 27) view tax compliance as:

> "*A continuum of definitions [that] ranges from the narrow law enforcement approach, through to wider economic definitions and on to even more comprehensive versions relating to taxpayer decisions to conform to the wider objectives of society as reflected in the tax policy.*"

Although researchers are still unable to adopt a 'universal' definition for tax compliance, these two studies show a more comprehensive idea of what tax compliance may be, by taking into account the importance of the need to recognize the existence of different

'layers' of tax compliance. From the thoroughness of the definitions adopted in the studies by James and Alley (2002) and Kastlunger et al. (2010), this suggests implicitly that a taxpayer may be 100 percent 'compliant', while another taxpayer may not be very 'honest', but does not breach the requirements required for being tax compliant. This then brings the discussion back to the term 'tax planning', where it can incorporate a number of variances on how 'compliant' a taxpayer is with their tax obligations depending on how much 'thought' and 'effort' they put into their tax obligations. However, due to the impracticality of attempting to distinguish between the various behaviours demonstrated by taxpayers to minimize their tax liabilities, the importance (as stated earlier) has been placed on the 'attitude' portrayed by a taxpayer when faced with their tax liabilities. By attitude of the taxpayer this means, to examine what it is to mean when a taxpayer takes into account the 'spirit' and/or 'letter' of the law, as well as considering whether compliance is voluntary or enforced.

This notion is further reinforced by James and Alley's (1999, p. 8) study where they distinguish between a taxpayer who 'comply' only because of "dire threats or harassment or both" against a taxpayer who, as stated earlier, "comply willingly, without the need for enquiries, obtrusive investigations, reminders, or the threat or application of legal administrative sanctions." Above that, James and Alley (1999) raised an interesting point where they believe the degree of 'full' compliance does not include payments of tax liability by taxpayers due to both economic and timing issues.

From an economic perspective, "money in the future is worth less than the same nominal sum of money now" (James and Alley, 1999, p. 8). Therefore, if taxpayers do not meet their tax obligations on time, then the government will need to either reduce "the revenue for public expenditure" (James and Alley, 1999, p. 8), or "[increase] the amount it has to raise elsewhere" (James and Alley, 1999, p. 8). As a result, James and Alley (1999, p. 8) propose that a more appropriate definition of voluntary compliance needs to be able to

differentiate on "the degree of compliance with tax law and administration which can be achieved *without* the actual application of enforcement activity [against enforced compliance]." However, more research is still required to develop a more descriptive definition for distinguishing between 'layers' of compliance to ensure that the definitions adopted will be able to accommodate for the various possibilities and combinations of compliance behaviour, whether voluntary or enforced.

Furthermore, James and Alley (2006) distinguish between compliance through complying with the 'letter' of the law and compliance through complying with the 'spirit' of the law. However, only a limited number of studies in this area have attempted to examine the definition for tax compliance from this perspective. The focus of dividing compliance between complying with the 'letter' and the 'spirit' of the law appears to be the next step up from distinguishing between 'voluntary' and 'enforced' compliance, which is a good direction of focus for future studies as it further examines the issue of considering 'layers' of compliance.

2.3 Tax Non-Compliance

Hasseldine and Li (1999, p. 91) describe tax non-compliance as a "substantive problem that transcends cultural and political boundaries." Being on the other end of the continuum to tax compliance, tax non-compliance seems to receive more attention from the literature where researchers have attempted to provide a more clear-cut line between categories of non-compliance. Kirchler (2007, p. 21) believes non-compliance represents the "most inclusive conceptualization referring to failures to meet tax obligations whether or not those failures are intentional." As with tax compliance, researchers have their own interpretations as to what non-compliance behaviours may incorporate, but in general, there

are two specific types of non-compliance, usually referred to as intentional or unintentional tax non-compliance (Erard, 1997; James and Alley, 2002; Book, 2003; and Kirchler, 2007).

Regardless of the perspective taken by researchers on analysing whether taxpayers' behaviours are intentional or otherwise, it is important to "examine separately the two main forms of taxpayer non-compliance: non-compliance through the overstatement of deductions; and non-compliance through the understatement of income" (Richardson and Sawyer, 2001, p. 224). From a wider perspective, the U.S. Department of the Treasury (2009) categorized non-compliance into three main groups. That is, non-compliance can either be in the form of: non-filing (taxpayers not filing a return at all or on time), under-reporting (amount filed by taxpayers does not include all required amounts to be filed) and under-payment (taxpayers may have filed their returns but do not pay the total tax liability due).

The three main groups of non-compliance are stated through examples where the causes of existing tax gaps are evident because of taxpayers not filing certain particulars, as well as taxpayers either underreporting or underpaying the balances of certain transactions throughout the financial year (U.S. Department of the Treasury, 2009). Interestingly, from the figures released by the U.S. Department of the Treasury (2009), under-reporting of receipts or over-reporting of expenses constitutes a significant portion of the gross tax gap at 82 percent, and the significant portion of under-reporting is the result of an understatement of individual income (at 50 percent). The categories of under-payment and non-filing constitute 10 percent and 8 percent, respectively (U.S. Department of the Treasury, 2009).

It is believed that a major source of non-compliance is the "presence of complex and ambiguously defined tax rules…which create opportunities for deliberate non-compliance [and] promote unintentional reporting errors…" (Erard, 1997, p. 355). However, the complexity of the tax system and the sophistication of the transactions should not be treated

as the sole factors contributing to the growing tax gap experienced by governments. Jackson and Jones (1985) have outlined several key determinants of taxpayers not complying with their tax obligations. This has included the probability of being detected by tax authorities, the way in which taxes are spent by the government, the position of the taxpayer (that is, whether they are due for a refund or whether they have a balance due), and also, whether a tax practitioner was engaged. The causes and effects of several other influential factors and methods of non-compliance have also been examined by researchers over the years (see Groenewegen, 1985 and Fischer, 1993), but unfortunately, the results from those studies are outside the scope of focus for this study. Therefore, the presence of these determinants raises the issue of whether non-compliance is intentional (which is not tolerated, but unpreventable) or unintentional (where amendments can be made to promote future compliance).

2.3.1 Intentional tax non-compliance

The main branches under the categories of intentional non-compliance are not always distinguishable, but the "activities are usually distinguished in terms of legality" (James and Alley, 1999, p. 31). Tax avoidance is usually referred to as taxpayers taking "legal measures to reduce tax liability" (James and Alley, 2002, p. 31). Wenzel (2002, p. 630) defines tax avoidance as behaviours relating to the "deliberate acts of reducing one's taxes by legal means." This again raises the issue on the difficulty to distinguish clearly between forms of non-compliance as "tax laws are not always precise" (Wenzel, 2002, p. 630). The ambiguity in the tax laws brings out an interesting thought that if taxpayers are seeking loopholes to minimize their tax liabilities, then even if the methods taken are legal, it may still be against the 'spirit' of the law and in this sense, considered to be non-compliance.

The online definition by Murphy (2010) has a slightly different variation in the definition for tax avoidance when compared with other studies, where it does not appear to treat tax avoidance as a form of 'deliberate' tax behaviour. Tax avoidance is defined by Murphy (2010) as where taxpayers seek to "minimise a tax bill without deliberate deception…but contrary to the spirit of the law. It therefore involves the exploitation of loopholes and gaps in tax and other legislation in ways not anticipated by the law." The aspect of 'without deliberate deception' seems to lean towards the kind of behaviour more commonly known as 'tax planning,' where it is commonly treated as an acceptable behaviour that exists within the main branch of tax compliance. Therefore, it is necessary to search for more studies on tax avoidance to be able to understand in more detail as to what sort of behaviours can be categorized under the main heading of tax avoidance, without being confused with other tax terms.

To add to the complex nature of the topic, McBarnet (2003, p. 229) introduces the concept of 'creative compliance' and defines it as "*not* non-compliance…but just like non-compliance, the essence of creative compliance is that it escapes the intended impact of the law." In addition, McBarnet (2003, p. 240) summarized this notion as "the product of two factors: the nature of [the] law and the attitude taken to it."

McBarnet (2003) also explains that appears to be a conflict in the argument as to whether creative compliance should be classified under the heading of tax compliance or non-compliance. In addition, he believes the issue of creative compliance goes "beyond tax avoidance" (McBarnet, 2003, p. 230), thus implying that it is a kind of non-compliant behaviour, but at the same time, McBarnet (2003) acknowledges that creative compliance is the result of taxpayers "finding ways to accomplish compliance with the letter of the law while totally undermining the policy behind the words (McBarnet, 2003, p. 229). Within this argument, there is an impression that creative compliance may be recognized as a 'layer'

within tax compliance as it does comply with the 'letter' of the law, but ignores (to a significant degree) the 'spirit' of the law. As a result, it is fundamental for future studies to establish how creative compliance should be defined and which branch of compliance or non-compliance the concept should be categorized into.

Further issues that need to be examined in relation to the concept of creative compliance include whether it should be categorized within tax non-compliance (due to some similarities it shares with tax avoidance), or whether it is perfectly acceptable, and therefore within the main branch of tax compliance. In addition, the general classification for the term creative compliance should also be looked into to determine whether it is logical (and practical) to treat creative compliance as an independent sub-branch within tax compliance as it may be difficult to draw a clear distinction between 'full' compliance and 'creative' compliance. Regardless of how creative compliance is to be treated and classified, the question of "whether it is perfectly legal or not is an unanswerable question, until it has won or lost in court," as concluded by McBarnet (2003, p. 232).

The study by Anderson (1993) appears to have incorporated both 'creative compliance' and 'tax avoidance' into a single study. Within the study, Anderson (1993, p. 185) had main categories of behaviours grouped in hierarchical order where both, "legally unacceptable but non-criminal avoidance" and "legally acceptable avoidance" were placed between 'tax evasion' and 'compliance', respectively. Although realizing the "difficulty in drawing lines" (Anderson, 1993, p. 185) between possible taxpayer behaviours, this study raises two interesting points for further research. First, the term 'tax avoidance' itself may be divided into sub-groups of its own. Second, it suggests that, creative compliance may be a synonym for tax avoidance in the wider context, but is deemed to be more serious than 'general' tax avoidance behaviours demonstrated by taxpayers. Further studies are required to support the ideas and statements made by Anderson (1993). But at the same time, the sole

focus of those studies should not be placed on attempting to differentiate between the 'types' of non-compliance behaviour, but rather, it is crucial to place an importance on whether the various behaviours can be grouped together to form generalizable conclusions in order to reduce the current level of confusions and misunderstandings.

In contrast to tax avoidance and how it has generally been known to be 'legal' behaviours to reduce one's tax affairs, Wenzel (2002, p. 630) defines tax evasion as "deliberate criminal non-fulfilment of tax liabilities" by taxpayers. In addition, Clyne (1979, p. 22) believes tax evasion to mean "fraud, dishonesty, false returns, double book entries, forgery and dishonest and/or illegal methods [to reduce one's tax liabilities]."

Wenzel's (2002) study suggests there are several 'types' of tax evasion and this may be further differentiated, as he argued that types of tax evasion may arise "not only because different types may be available to different groups of taxpayers but also because these types could have different qualities and involve different processes" (Wenzel, 2002, p. 630). In addition, Wenzel (2002) differentiates between the possible types of tax evasion by categorizing a particular taxpayer's behaviour as either involving an unlawful act of commission[8] or an unlawful act of omission.[9] Murphy's (2010) webpage states that, as with tax evasion, unintentional tax non-compliance may be in the form of "non-payment or under-payment of taxes." Furthermore, Murphy (2010) describes that these kinds of behaviour may be evident from the "making of a false declaration or no declaration at all of taxes due to the relevant tax authorities…"

[8] The example given by Wenzel (2002, p. 630) is "a false statement on deductions."
[9] The example given by Wenzel (2002, p. 630) is "not reporting some case income."

Tax evasion can be seen as "a large social problem," (Hasseldine, 1999/2000, p. 228) where this type of behaviour is usually perceived by economists who see taxpayers as "utility maximizers who will evade tax whenever the projected benefit exceeds the costs" (Tan, 1998, p. 61). It has been asserted that tax evasion involves both economic and psychological factors, and the degree of evading taxes strategically influences the degree of compliance in general (James and Alley, 2006). As a result, some researchers have voiced their concern that if "taxpayers go to inordinate lengths to reduce their liability this could hardly be considered 'compliance' " (James and Alley, 1999, p. 5).

2.3.2 Unintentional tax non-compliance

As with the layers and sub-categories within tax compliance and non-compliance, it is difficult to fully distinguish the difference between *intentional* and *unintentional* non-compliance. Within this grey area, even the IRS does not have "sufficient data to distinguish clearly the amount of non-compliance that arises from wilful, as opposed to unintentional, mistakes" (U.S. Department of the Treasury, 2009, Appendix, p. 2). Without a doubt, this is an area requiring more work so that it becomes less difficult to be able to differentiate between the two generic areas within tax non-compliance.

Studies have described unintentional tax non-compliance as "not necessarily implying the violation of law" (Kirchler, 2007, p. 21), but that it is still unlawful with a taxpayer failing to meet their tax obligations (Wenzel, 2002). Such non-compliance behaviours may be due to several factors including the complexity of law, interpretative issues and misinformation, misunderstanding, and calculation errors of tax matters when dealt with by taxpayers (Erard, 1997; Wenzel, 2002; and Book, 2003).

There is also the difficulty of distinguishing between 'lazy' and 'unknown' tax non-compliance. Lazy non-compliance refers to "taxpayers' failure to provide the appropriate information necessary to substantiate an item on a tax return" (Book, 2003, p. 1824), while unknown non-compliance "results in errors caused by ambiguous, complex or changing rules" (Book, 2003, p. 1824).

As with the distinction on tax evasion through acts of commission and omission, the same principle can be applied here for unintentional tax non-compliance. Acts of commission and omission can be viewed as synonymous for 'lazy' and 'unknown' tax non-compliance. The study by Spranca et al. (1991, p. 76) suggest that acts of commission usually involve "more malicious motives and intentions than the corresponding omissions; and commissions usually involve more effort, itself a sign of stronger intentions." In contrast, acts of omission may be the result of 'ignorance', where taxpayers believe it is "less immoral or less bad as decisions, than harmful commissions" (Spranca et al., 1991, p. 76).

As with the study by Wenzel (2002), Spranca et al. (1991) also believe that these two acts are different in terms of severity (acts of omission could be considered as less severe than acts of commission) and legality, but again, it is difficult to draw a clear distinction between omission and commission. This issue is similar to the complication of attempting to differentiate between 'lazy' and 'unknown' tax non-compliance. As a result, further research needs to focus on finding ways to define objectively what may be recognized as 'unintentional tax non-compliance', rather than purely giving descriptions or examples of what amounts to 'unintentional tax non-compliance' behaviour. Furthermore, future research should focus on whether it is really necessary to divide the behaviours within unintentional non-compliance as this further hinders the goal of having harmonized definitions for the general concepts of tax compliance and non-compliance.

2.4 Over-Compliance

Considerable emphasis has generally been placed within the area of tax non-compliance (or under-compliance); however, the concept of over-compliance does not seem to be researched to a significant degree. It was not until the late 1980s that researchers begin to place a focus on the issue of taxpayers paying more tax than they are legally required to, as opposed to not paying sufficient tax. Given its name, this area should be classified as a sub-category of non-compliance as the sum of taxes paid is 'theoretically' or 'mathematically' incorrect. Consequently, it cannot be considered to be a form of tax compliance behaviour from a taxpayers' perspective. However, it may also be argued that, as opposed to not paying (or under-paying) one's tax liabilities and therefore causing problems in the efficiency of the tax system, a taxpayer has actually paid more than what was legally required, and therefore, should be placed somewhere in-between the two extremes of tax compliance and non-compliance. By comparing these two forms of non-compliance (the under-payment and over-payment of one's tax obligations), over-compliance is without a doubt more welcomed by government authorities. But when taking into account the 'purpose' and 'cause' of why such behaviours exist, then both under-compliance and over-compliance, should be eliminated, or at least reduced, to a tolerable extent.

The study by Walkey and Purchas (1998) recognize over-compliance as a sub-category within non-compliance. Within their study, over-compliance is acknowledged as a form of 'mistaken' behaviour, where it is the result of accidental errors demonstrated by taxpayers. It has been stated in Roth et al. (1989, p. 21) that over-compliance can be noted as 'over-reporting' because "the taxpayers reports a greater liability than required." Most taxpayers are risk-averse in nature, and may prefer to over-pay the actual level of taxes due rather than having to pay interest costs and penalties if they are found to be underpaid after a tax audit.

A 2002/03 reform of the New Zealand tax policy and the legislation framework contributed to the increased level of over-paid taxes by taxpayers annually (Sung, 2009). This regime "requires wages and salary earners to file a tax return by requesting a personal tax summary if they desire to receive their income tax refunds" (Sung, 2009, p. 2). Since it is no longer mandatory for a proportion of taxpayers to file tax returns, this has resulted in around $100 million of 'over-paid' taxes in New Zealand to Inland Revenue each year (Sung, 2009). As a result, emphasis should be placed on helping taxpayers to claim their entitled over-payment of taxes, rather than leaving it up to the taxpayers to calculate whether they have a refund due. This is because; the 'extra' taxes collected by the government should not be treated as amounts to 'balance out' the level of taxes lost from non-compliant activities.

In addition, some taxpayers may be disadvantaged by the self-assessment regime where they do not have the knowledge about requesting a personal tax summary or filing a tax return (Sung, 2009). Furthermore, with tax being an extremely complex topic, some taxpayers may find filing a tax return to be too time-consuming, confusing or difficult (Sung, 2009). Regardless of the reason for not filing a tax return, it is evident that Inland Revenue does not "follow up taxpayers who either do not request their personal tax summaries or do not claim their refunds, even if Inland Revenue is aware that theses taxpayers are entitled to a refund" (Sung, 2009, p. 31). This suggests that taxpayers themselves need to be more 'pro-active' with their own tax obligations to avoid the over-payment of taxes unintentionally. The study by Sung (2009) included a preliminary study on the aspect of 'over-compliant' taxpayers who may be losing the 'extra' taxes paid by way of unclaimed refunds. Sung (2009, p. 40) concluded that, "it is not reasonable to rely on the self-assessment regime for over-compliant taxpayers and have an enforcement programme for under-compliant taxpayers…" Therefore, more research is required within this area to further analyse the issues associated with over-compliance, and whether a universal definition could be attributed to this concept.

3.0 Literature Review- New Zealand Case Law and Tax Compliance

3.1 Recent New Zealand Case Law Concerned with Tax Compliance and Tax Non-Compliance

In general, case law tends to focus on the various kinds of actions demonstrated by taxpayers that would be classified as either tax avoidance or tax evasion behaviour, rather than utilizing a 'pre-determined' definition (e.g. from a particular study or case) to determine on the outcome of a particular case. This is achieved through the courts interpreting and applying the relevant legislation. Before reviewing some of New Zealand's recent case law, it is crucial to consider the importance of section BG 1 from the Income and Tax Act 2007 ("ITA 2007"), known as the 'general anti-avoidance provision'.[10] The purpose of this provision is to allow for the Commissioner to "distinguish between transactions involving tax avoidance and those involving legitimate tax planning" (Ohms, 1996a). Despite the growing challenge to make a clear distinction between the various forms of tax minimisation oriented activities, the ability to determine certain boundaries for various non-compliant activities are still important (although not always achievable).

New Zealand has had a general anti-avoidance provision since 1878 (*Ben Nevis* Supreme Court, 2008). At the time, the focus of the general anti-avoidance provision was mainly intended to ensure that land tax was paid by the landlord, rather than placing an importance on whether taxpayers have met their income tax obligations.

[10] Section BG 1 from the ITA 2007 is the equivalent of section BG 1 from the Income Tax Act 2004, section BB 1 from the Income Tax Act 1994, section 99 from the Income Tax Act 1976, and section 108 from the Income Tax Act 1954.

However, with the growing concern over the number of taxpayers involved in non-compliant activities, income tax was later addressed separately in 1916 when the redrafted provision was directed to tax avoidance (*Ben Nevis* Supreme Court, 2008). Although the general anti-avoidance provision in tax legislation was established as early as in 1879, it was not until the 1960s when the Commissioner began to heavily rely on the general anti-avoidance provision in courts (*Ben Nevis* Supreme Court, 2008). Prior to 1965, the Land and Income Tax Act 1954 was in force, but from 1965 onwards, criticisms for the relevant section increased due to interpretational difficulties in court (Coleman, 2009), where it was difficult to identify when "permissible use of specific provisions ends and [when] tax avoidance begins" (*Ben Nevis* Supreme Court, 2008, paragraph [71]). In 1974, changes were made to the anti-avoidance provision in section 108 from the Income Tax Act 1954 to clarify the types of transactions the section was intended to cover, extending the definition for tax avoidance in order to accommodate for a wider range of possible tax advantages (*Ben Nevis* Supreme Court, 2008).

The new definition for a 'tax avoidance arrangement' was articulated as including an arrangement "where one of its purposes was tax avoidance, that not being a "merely incidental" purpose" (*Ben Nevis* Supreme Court, 2008, paragraph [81]). Although an improvement was made for section 108 from the Income Tax Act 1954, the amendment still did not "explicitly address how to discern the relationship between allowing tax concessions for certain arrangements and the general anti-avoidance provision, which struck down arrangements having a purpose or effect of tax avoidance that was not merely incidental" (*Ben Nevis* Supreme Court, 2008, paragraph [83]).

In 2001, a comprehensive review was commissioned by the Labour government to review New Zealand's tax system, and although it was noted that there was a "lack of consensus on the effectiveness of section BG 1[11]" (Alley et al., 2009, p. 1043), the section remain unchanged.

Nevertheless, the three limbs of tax avoidance from section YA 1 of the ITA 2007 (see Appendix B) has appeared to be a useful criteria as a starting point for considering whether a particular act of behaviour is tax avoidance/tax evasion, because this section has been labelled as the "Commissioner's heaviest anti-avoidance artillery" (Prebble, 2006, p. 117). Without a general anti-avoidance provision (such as section BG 1), it is highly likely that taxpayers would be arranging their tax affairs more freely to minimize their tax obligations, and as was discussed in the introduction, this will be a threat to both the government and the country's economy.

Section BG 1 "relies heavily on the judicial process to define [the] boundary between legitimate and voidable tax planning" (Alley et al., 2009, p. 1043), but this is also a criticism where too much reliance has been placed by the courts to assert the boundary between acceptable tax planning and unacceptable tax avoidance. The general anti-avoidance provision has been found to be "deceptive in their simplicity [but] they have not always been easy to apply in practice" (*Penny and Hooper* Court of Appeal, 2009, paragraph [110]). Therefore, it is important to note that the general anti-avoidance provision should only be seen as "being intended to support, not override other provisions of the income tax legislation"

[11] Section BG 1 from the ITA 2007 is as follows:

BG 1 Tax Avoidance

Avoidance arrangement void

(1) A tax avoidance arrangement is void as against the Commissioner for income tax purposes.

Reconstruction

(2) Under Part G (Avoidance and non-market transactions), the Commissioner may counteract a tax advantage that a person has obtained from or under a tax avoidance arrangement.

(Coleman, 2009, p. 33) when dealing with tax avoidance issues in court. The following section describes some of New Zealand's recent case law and examines the principles and approaches adopted by the Judiciary when determining the outcome of a particular case. This section will also consider how the relative concepts (especially the concepts of tax avoidance and tax evasion) have been defined (either implicitly or explicitly) within the cases. In addition, these cases will form as the basis of discussion when more cases are reviewed in Chapter 6.

3.2. Tax Avoidance Cases

3.2.1 Ben Nevis Forestry Ventures Ltd & Ors v Commissioner of Inland Revenue [2008] SC 43/2007 NZSC 115

This case (hereafter referred to as the '*Ben Nevis*' case) is concerned with a group of taxpayers involved in complex schemes which had the purpose and effect of avoiding tax. As a result, the Supreme Court (SC) held that the scheme deployed by the taxpayers was a tax avoidance arrangement. The *Ben Nevis* case is a landmark case for New Zealand. Not only did the case involved complicated transactions that leaned towards the grey areas of the tax legislation, the case also provided clarity on the application of the specific and general anti-avoidance provisions. Also, *Ben Nevis* is "New Zealand's first Supreme Court decision concerning the interpretation and application of the general anti-avoidance provision" (Coleman, 2009, p. 67).

It was held by the minority (Elias P and Anderson J) that it is important to look at both the specific statutory allowances provided for the taxpayers, as well as the general anti-avoidance provision, as the two "do not need reconciliation" (*Ben Nevis* SC, paragraph [2]). The minority go on to state that "both are to be purposively and contextually interpreted…" (*Ben Nevis* SC, paragraph [2]). Nevertheless, the minority did agree with the majority's

(Tipping, McGrath and Gault JJ) decision that the scheme was a tax avoidance arrangement, but they went into extra lengths to examine the specific tax provisions from the Income Tax Act, and they do not believe that those provisions are "potentially conflicting" with the general anti-avoidance provision (*Ben Nevis* SC, paragraph [7]).

The investors (appellants) were involved in a Douglas Fir forest project known as the 'Trinity' scheme, where the forest was due to be harvested 50 years later (that is, in 2048). By taking advantage of the forestry deduction rules, the arrangement involved complex steps where the investors "effectively met the initial costs of buying the land and planting the forest and the continuing costs of its future maintenance and management" (*Ben Nevis* SC, paragraph [23]). However, under the licence and insurance premium arrangements, the investors did not acquire ownership of the land, nor the trees. In 1998, the investors amortised licence premiums in their tax returns, as well as claiming expenses unrelated to the costs of planting and tendering trees. As a result, the Commissioner argued that the arrangement made between the parties was a sham, because the taxpayers had "altered the incidence of income tax by means of a tax avoidance arrangement" (*Ben Nevis* SC, paragraph [156]).

As noted in the case, it is important to distinguish between *sham*[12] and *avoidance*. As opposed to documents not reflecting the true nature of what the parties agree on (that is, a 'sham'), avoidance occurs when "the documents may accurately reflect the transaction which the parties intend to implement [but] the arrangement entered into gives a tax advantage which Parliament regards as unacceptable" (*Ben Nevis* SC, paragraph [34]). The Supreme court did not accept the Commissioner's 'sham' argument as the court held that even though

[12] Diplock LJ's Supreme Court judgment for *Snook v London and West Riding Investment Ltd* [1967] 1 All ER 518, described a 'sham' in the law context as being:

> "*Designed to lead the taxation authorities to view the documentation as representing what the parties have agreed when it does not record their true agreement. The purpose is to obtain a more favourable taxation outcome than that which would have eventuated if documents reflecting the true nature of the parties' transaction had been submitted to the Revenue authorities*" (paragraph [33]).

the arrangement were entered into for the *purpose* or *effect* of obtaining a tax advantage, this does not itself mean that it was a sham (see *Ben Nevis* SC, paragraph [38]). The words such as, 'contrivance' and 'artificiality' were mentioned in the case where they were treated as factors indicating avoidance (see *Ben Nevis* SC, paragraph [97]), however, "what is meant by the words contrivance and artificiality is not entirely clear" (Coleman, 2009, p. 74).

The meaning of 'purpose' and 'effect' from a taxation context was considered in *Newton* (1958, paragraph [445]),[13] where the word 'purpose' means, "not motive, but the effect which it is sought to achieve - the end in view. [On the other hand], the word 'effect' means the end accomplished or achieved. The whole set of words denotes concerted action to an end - the end being avoiding tax."

As a result, the appeal made by the taxpayers to the Supreme Court in *Ben Nevis* was that they had "satisfied the ordinary meaning of the specific provisions relied on to claim the deductions" (*Ben Nevis* SC, paragraph [156]), but they had failed to show "that the specific provisions they relied on had been used in a manner which was within Parliament's purpose and contemplations when it enacted them" (*Ben Nevis* SC, paragraph [156]). Therefore, the Supreme Court dismissed the appeal made by the taxpayers and concluded the taxpayers had been involved in a tax avoidance arrangement.

Beneath the scheme and purpose approach emphasized by the Supreme Court lies the interpretation issue due to the ambiguity in tax law. For example, this was seen through the Supreme Court's approach to the interpretation of whether the taxpayers were involved in a sham, as opposed to a tax avoidance arrangement. Scoular and McVeagh (2009, p. 103) emphasize the importance of the view endorsed by the Supreme Court where "the existence of tax avoidance is generally inconsistent with the existence of a sham," and therefore,

[13] *Newton v Federal Commissioner of Taxation* (1958) 98 CLR 1 (PC).

"allegations of both tax avoidance and sham" should not be made in the same case discussion. In order to resolve interpretational issues, it is necessary for the court to "choose the meaning that best fits with the purpose of the legislation" (Blanchard, 2009, p. 89).

This judgment from *Ben Nevis* may seem to have magnified a certain level of implication on the importance to differentiate between complying with the 'letter' and 'spirit' of the law. For example, the amount of deductions claimed by the taxpayers did fall under specific provisions, that is, it had complied with the 'letter' of the law. However, the 'spirit' of the law was totally undermined because the intention behind taxpayers claiming the deductions did not fall within Parliament's intended scope. This was seen through the fact of the case where investors were claiming "allowances in respect of amortisation of a licence fee for use of land for forestry purposes and in respect of premiums for insurance against the risk that the forest would not yield a specified return" (*Ben Nevis* SC, paragraph [6]).

From this case, tax avoidance is deemed to have occurred when "the object or end in view or design of an arrangement is alteration of the incidence of tax and that object is not incidental to a business purpose [and] such assessment does not entail reconstruction of the arrangements entered into" (*Ben Nevis* SC, paragraph [9]). That is, if the tax avoidance purpose or effect of an arrangement is merely incidental, then the arrangement executed by the taxpayers would not be considered to be a tax avoidance arrangement. The importance therefore lies in how the arrangement is executed, while "bearing in mind Parliament's purpose with respect to both the specific black letter provision in question as well as the general anti-avoidance provision," and if the tax benefit gained is outside the Parliament's intended purpose, the arrangement will amount to tax avoidance (Coleman, 2009, p. 59). Apart from the legal considerations, it is also important to consider "the use made of the specific provision in the light of the commercial reality and the economic effect of that use"

(*Ben Nevis* SC, paragraph [109]), when determining whether a tax avoidance arrangement has been entered into.

Therefore, the *Ben Nevis* case is an extremely important case in New Zealand as it raises several crucial factors to consider when deciding whether an arrangement is tax avoidance (see Appendix C). First, it raises the importance to assess equally both the *fact* and *law* for the cases, where a realistic assessment of commerciality and economic substance is necessary to determine the *purpose* and *effect* of an arrangement. Second, even if a legitimate legal structure (or entity) has been adopted, it may still be possible for the arrangement to be artificial and contrived (that is, tax savings are not merely incidental if there is a 'consensus' between the parties involved).[14] A 'consensus' between the parties refers to whether there is a meeting of minds that there is an expectation on the part of each that the other will act in a particular way (Coleman, 2009).

3.2.2 Penny v CIR; Hooper v CIR [2009]24 NZTC 23,406; *Commissioner of Inland Revenue v Ian David Penny and Gary John Hooper* [2010] NZCA 231; *Penny and Hooper v Commissioner of Inland Revenue* SC 62/2010 [2011] NZSC 95

The two plaintiffs (Messrs Penny and Hooper) were both orthopaedic surgeons in the public health sector in Christchurch, as well as operating private practices where the income from the practices was their personal income. Later, both incorporated their practices into companies, and they became employees of their practices, and received employment income in order to reduce exposure to potential negligent claims from clients. As a result of this transformation in the business structure, the Commissioner alleged that this transformation has amounted to a tax avoidance arrangement under section BG 1 of the ITA 2004 because

[14] This is especially evident from the *Penny and Hooper* case judgments (see Chapter 3.2.2).

the sole purpose of incorporating their practices was to reduce the amount of income taxes payable. Furthermore, the Commissioner was under the impression that there was a lack of commercial purpose for turning their practices into incorporated businesses and therefore issued several assessments for a number of income years to both plaintiffs. Other factors considered by the Commissioner included the artificially low salary levels the surgeons earned after the business transformation and how the formation of the business has altered the incidence of tax where a different rate was paid and how tax was payable by a different taxpayer. However, the plaintiffs believed they were not engaged in tax avoidance arrangements; hence they challenged the validity of the assessments.

The view adopted by the Supreme Court's decision in *Ben Nevis* (2008) is the importance to endorse a 'scheme and purpose' approach. It is stated by the High Court (HC) in *Penny and Hooper* that "the inquiry into scheme and purpose is to be conducted having regard to the arrangement as a whole, not to its constituent parts" (*Penny and Hooper* HC, paragraph [22]). In addition, as a number of steps have been taken to the formation of a company, it is necessary to consider that "when conducting the formation requisite scheme and purpose analysis, to consider the scheme and purpose of each set of specific provisions" (*Penny and Hooper* HC, paragraph [22]). It was agreed that the transfer of the practices into a company did alter the incidence of tax, but, based on the scheme and purpose approach to the interpretation of the anti-avoidance provisions, "that alteration is not, of itself, sufficient to bring the situation within the definition of tax avoidance" (*Penny and Hooper* HC, paragraph [25]). This is because of the importance to determine "by whom income is derived and what tax is payable by the person deriving that income [and] whether the incidence of tax is consistent with the intent of these specific provisions" (*Penny and Hooper* HC, paragraph [25]).

The outcome of this particular case at the High Court was that although the plaintiffs did gain tax advantages from the formation of the company and transferring their business to it, that tax advantage was "a change which was consistent with the specific provisions of the Act, and not contrary to any principle to be discerned from the scheme and purpose of the Act" (*Penny and Hooper* HC, paragraph [44]). It has been noted that the "arrangement as a whole is not one which has the purpose or effect of tax avoidance" (*Penny and Hooper* HC, paragraph [81]), but rather, the tax advantages gained are to be considered as '*merely incidental*' as a result of the transformation in business structure. This decision is largely influenced by the Judges accepting the evidence given by Penny and Hooper that they had genuine reasons to adopt a corporate structure to minimize exposure to personal claims. Also, MacKenzie J accepted Messrs Penny and Hooper's evidence that they had concerns for potential claims and believed that this reason had been "realistic" and therefore acted as the "motive" (rather than the "purpose") for the transformation of their practices into businesses (*Penny and Hooper* HC, paragraph [46]).

Again, this case applied section BG 1 from the ITA 2004 as a starting point for considering whether the changes in the structure of the plaintiffs' practices is a tax avoidance arrangement. The High Court adopted the views formed by the Supreme Court in *Ben Nevis* (2008) that:

> "*Tax avoidance can be found in individual steps or, more often, in a combination of steps. In addition, it is also important to consider the 'commerciality' of an arrangement, and whether there is artificiality in the arrangement to determine whether that particular arrangement constitutes tax avoidance. Indeed, even if all the steps in an arrangement are unobjectionable in themselves, their combination may give rise to a tax avoidance arrangement*" (paragraph [105]).

The minority of the Supreme Court in *Ben Nevis* (2008) provided a detailed understanding of what tax avoidance may entail, by stating:

> "*Tax avoidance occurs when the object or end in view or design of an arrangement is alteration of the incidence of tax and that object is not incidental to a business purpose. Such assessment does not entail reconstruction of the arrangements entered into. It requires realistic assessment of their purpose or effect*" (paragraph [9]).

Therefore, it is evident that the case of *Penny and Hooper* emphasizes the importance to distinguish between whether tax avoidance is the primary goal of altering a particular business arrangement, and whether the tax advantage is purely incidental subsequent to the reconstruction of a particular business arrangement. The way that this case focuses on distinguishing between the 'goal' and 'merely incidental' of an arrangement is an enhanced method for assessing the weighting contributed by tax avoidance behaviours as a result of how much tax has been 'saved' by the taxpayers, as well as calculating the 'flow-on' effects as a result of altering a particular business plan or structure. An interesting view raised from the result of MacKenzie J's opinion is that the amount of tax advantage alone cannot determine whether tax avoidance is present as he states in paragraph [80] that, "the quantum of tax involved is unlikely to be, on its own, a reliable indicator of whether the tax avoidance purpose or effect is merely incidental to some other purpose."

Lastly, this case also shows the difficulty of attempting to challenge on a factor, such as, the undefined term of a 'commercially realistic salary' that is not specifically defined in the legislation. This is evident from the Court of Appeal's judgment where it states that a 'realistic salary level' is "not a concept known to tax law" (paragraph [52]). In *Penny and Hooper*, the Commissioner argued that the taxpayers were receiving an artificially low salary level, and should therefore be a solid factor contributing to tax avoidance. However, the High

Court believe the level of an ‘acceptable’ salary for orthopaedic surgeons depended on many factors (such as: qualifications and experience) and there is no pre-determinate ‘market’ rate for it, let alone attributing a realistic salary level for Messrs Penny and Hooper. Therefore, it was impractical for the Judiciary to allocate a salary figure that is ‘commercially realistic’ for Messrs Penny and Hooper.

The decision from the High Court was appealed by the Commissioner and surprisingly, the Court of Appeal (COA) overturned High Court’s decision. The majority concluded that the appeal was allowed as the change in business structure by Penny and Hooper did constitute tax avoidance behaviour. The appeal made by the Commissioner did not “challenge the legitimacy of the company/trust structures adopted,” (*Penny and Hooper* COA, paragraph [72]) but instead, the Commissioner focused on:

> “*[The] manner in which the structures were used, including, most importantly, the decisions made by the taxpayers to allocate to themselves a salary from their respective companies which were…at levels substantially below those which would be appropriate in an arms-length commercial context*” (*Penny and Hooper* COA, paragraph [72]).”

The Commissioner submitted that, when the ‘arrangement’ was viewed as a whole, it could be described as “artificial, contrived and beyond Parliamentary contemplation as a legitimate business arrangement” (*Penny and Hooper* COA, paragraph [86]).

Also, the COA noted that Messrs Penny and Hooper’s daily work arrangements did not change after the formation of their businesses, as they still saw the same number of patients and their letters are still addressed personally to them, rather than to the company. This implies that the way in which a structure is ‘adopted’ (or formed) is equally important as the way a structure is ‘executed’ by the parties concerned in order to assess whether tax

savings are intended (or just merely incidental). Therefore, in order to assess whether there is a tax avoidance arrangement, it is necessary to assess "all the circumstances including the extent and nature of any element of artificiality or contrivance in order to determine whether any particular arrangement is within or outside the contemplation of Parliament in enacting the tax legislation" (*Penny and Hooper* COA, paragraph [126]).

The Court of Appeal's judgment for *Penny and Hooper* stated in paragraph [78] that an arrangement is "not limited to a specific transaction or agreement but may embrace a series of decisions and steps taken which together evidence and constitutes an agreement, plan or understanding." In relation to the meaning of an 'arrangement', it is believed that although the set up of a company entity was acceptable within the legislation concerned, the tax advantages gained as a result of the change in the business structure was "more than a merely incidental purpose or effect [of the arrangement concerned]" (*Penny and Hooper* COA, paragraph [122]) due to the unrealistic level of salaries paid out to Messrs Penny and Hooper. This is supported by the argument made in paragraph [122], where the salary levels could:

> "*Not have been within the contemplation of Parliament that a company director/employee could adopt a salary of less than one-fifth of a proper commercial salary and thereby secure significant tax advantage while still receiving, in practical terms, the benefit of the company's entire net income for himself and his family.*"

In contrast, Messrs Penny and Hooper argued that there has never been a case in New Zealand for the "Commissioner to challenge salary levels except in very limited contexts…" (*Penny and Hooper* COA, paragraph [87]). Ironically, the decision from the Court of Appeal focuses largely on the unrealistic levels of salary paid to Messrs Penny and Hooper, rather than taking into account other reasons which may be legitimate for Messrs Penny and Hooper

for setting up the company/trust. Messrs Penny and Hooper's acceptance "without hesitation" that the "salaries were at levels substantially below [that is, less than one-fifths] what could have been expected if they had been employed independently at arm's-length [transactions]" (*Penny and Hooper* COA, paragraph [114]) acted as a strong indicator for the Court of Appeal to allow the appeal made by the Commissioner.

Furthermore, Randerson J (part of the majority) disagreed with the need to adopt company structures for "protection against negligence claims" (*Penny and Hooper* COA, paragraph [121]). However, it may be unfair for the Judges to decide whether a transformation in the structure for the company was required as they are not the direct parties involved in the running of the practices. Also, there is no specific provision in tax law preventing taxpayers from organizing their best suited business structures. As a result, this argument is subjective because Ellen France J (the minority) agreed with the decision reached by the High Court, where, "neither the formation of the companies with the resultant change in the incidence of tax nor the salary arrangements were inconsistent with the scheme and purpose of the Income Tax Act" (*Penny and Hooper* COA, paragraph [165]).

Therefore, from the combined judgments reached by the Court of Appeal, it highlights the importance of looking at not only the 'arrangement' itself, but also the events which may have occurred *before* and *after* the 'arrangement' in question, to consider whether a particular 'arrangement' is primarily planned for tax savings (and therefore, tax avoidance) or whether the arrangement carried out by the taxpayer has sound commercial reasons (with tax savings being merely incidentals), as was seen in the High Court judgment of the *Penny and Hooper* case.

In August 2011, the Supreme Court (SC) found for the Commissioner, confirming that the allocation of Messrs Penny and Hooper's salaries was set at artificially low levels. As a result, the appeal made by Messrs Penny and Hooper was dismissed. It is acknowledged that although the business structures adopted were "entirely lawful and unremarkable" (*Penny and Hooper* SC, paragraph [33]), it was Messrs Penny and Hooper's avoidance of paying the highest personal rate that raised the tax avoidance problem. Not only were Messrs Penny and Hooper's salaries at unrealistic levels, it was also noted by Blanchard J that "it can hardly be a coincidence that this [the adoption of a new business structure] was done as soon as that personal tax rate was increased to 39 cents in the dollar, and not before that change was made by Parliament" (*Penny and Hooper* SC, paragraph [33]). The change in the *timing* of the business structure could be said to have a significant influence on the outcome of the case as it occurred during a time period that were both sensitive and questionable.

Again, the question of what is a 'commercially acceptable salary level' was raised. Both Messrs Penny and Hooper carried out the same level and extent of services as before, but were remunerated at a much lower rate. They both accepted that "they would not have entered into these arrangements with an unrelated party and that the salaries for the years in question were commercially unrealistic" (*Penny and Hooper* SC, paragraph [16]). However, Messrs Penny and Hooper submitted that "there is no concept of a commercially realistic salary to be found in the Income Tax Act…" (*Penny and Hooper* SC, paragraph [49]) and therefore, this factor could not be argued against them. But unsurprisingly, Blanchard J points out that the Act does intend for taxpayers to "not structure their transactions with a more than merely incidental purpose of obtaining a tax advantage unless that advantage was in the contemplation of Parliament…" (*Penny and Hooper* SC, paragraph [49]).

In determining whether or not a commercially realistic salary is paid to taxpayers, it is appropriate for the Commissioner to examine the issue and "if the salary is not commercially realistic or, objectively, is not motivated by a legitimate (that is, non-tax driven) reason, it will be open to the Commissioner to assert that is was, or was part of, a tax avoidance arrangement" (*Penny and Hooper* SC, paragraph [49]). This statement states implicitly that it may be possible for taxpayers to be paid a below market salary, but only if the facts and circumstances of each particular case can be reasonably justified.

The argument of whether tax avoidance can be found in a single step or in a combination of steps was reinforced again in the Supreme Court judgment. It is agreed that the formation of the companies and trusts were within the contemplation of the law. However, the step taken by the taxpayers to take advantage of the tax savings led to a tax avoidance arrangement. This critical step was taken by Messrs Penny and Hooper where they allocated to themselves "an artificially low level of salary which had the effect of altering the incidence of taxation," (*Penny and Hooper* SC, paragraph [33]) and therefore, leading to the Supreme Court in believing that there was a tax avoidance arrangement. Paragraph [34] of the Supreme Court judgment states that this step, when taken, "can make the wider arrangement a tax avoidance arrangement." Nevertheless, it is also necessary to consider the purpose and effect of the artificially low salary levels on each occasion, as in this situation, this particular 'step' was taken repetitively over the years where tax savings were gained (see *Penny and Hooper* SC, paragraph [34]).

The statement by Messrs Penny and Hooper that the formation of new business structures was to protect themselves from professional negligence claims was insufficient for the Supreme Court to deem it not to be tax avoidance behaviour. Although this 'purpose' was accepted by the Supreme Court, it was held that "it cannot have been the sole or a dominant purpose because of the protection already in place through the combination of the accident

compensation [the accident compensation corporation(ACC)] scheme and insurance cover" (*Penny and Hooper* SC, paragraph [36]). This further confirms that the tax savings from the artificially low salary levels were not merely incidentals, and therefore, constituted as a part of the tax avoidance arrangement. These considerations made by the Judiciary all lead to how tax avoidance behaviours may be determined, as opposed to giving an explicit definition for the concept itself.

3.2.3Case Z24 [2010] 24 NZTC 14,354 (NZ TRA); *White v The Commissioner of Inland Revenue* [2010] HC AK CIV 2010-404-1188

This case is very similar to *Penny and Hooper* where the issue arises as a result of a change in the restructure of the business and the allocation of an anaesthetist's salary at a relatively low level. The restructuring of the business involved the setting up of a new company and the arrangement involved a family trust of owned assets that was closely related to the private practices provided by the disputant (that is, White) and her husband. As was the case in *Penny and Hooper*, the stated reason for the restructuring was to protect the family from potential exposure to claims against the services provided. After the restructuring of the business structure, White performed the same services as before, but was either receiving no salary or at an artificially low level. The reason for the lack of salary was (supposedly) due to the insufficient level of income earned from the newly formed company. However, the company appeared to be paying above normal market rates to lease the orchard.

It was held by the Taxation Review Authority (TRA) that White was "unremunerated in a manner which is artificial and contrived and has no sensible reality" (TRA, paragraph [23]), and therefore, engaged in tax avoidance behaviour. Again, a two step process set out in the *Ben Nevis* case was adopted here to establish what constituted tax avoidance behaviour. The first step was to determine "whether or not the taxpayer has used specific tax provisions

within their intended scope" and second, to consider "the use of the specific provisions as a whole" (see *Ben Nevis* Supreme Court, paragraph [107]). It is acknowledged from the case that it is important to examine *objectively* the *purpose* and *effect* of an arrangement by looking at the "overt acts done in pursuance of the whole arrangement" (TRA, paragraph [52]). However, it is not to say that the formation of any company constituted tax avoidance behaviour, but rather, "it is the artificial use of these structures to reduce tax paid in respect of income generated through the disputant's personal exertions, while retaining full control over and benefit from that income which amounts to tax avoidance" (TRA, paragraph [83]).

The allocation of an artificially low income did not amount to it being a 'commercial' motif for the restructuring and the low level salary allocated to White was definitely not '*merely incidental'* as a result of the restructure, as observed by Judge Barber. It was concluded that an 'arrangement' was in place, and the arrangement had the purpose or effect of tax avoidance. The decision reached from this case supports the judgments from both the *Ben Nevis* and *Penny and Hooper* cases where tax avoidance behaviour can either be found in a single step, or in a combination of steps within a particular arrangement. The important factor to consider is to not only look at the arrangement itself, but also at whether the tax savings are merely incidental as a result of the business restructure. Furthermore, it is also important to examine the commercial aspects of the arrangement where the restructuring of the business took place.

From these three cases, the Judges appear to have adopted a similar approach (as discussed above) when examining whether a particular arrangement is to be constituted as tax avoidance behaviour. However, this is not to say that there is only one uniform method when dealing with future cases of a similar nature, or ascertaining what the concept of tax avoidance may entail.

In late 2010, the decision delivered by the TRA was overturned by the High Court (HC), where Heath J believed that the restructuring of business did not amount to tax avoidance. Before arriving at the decision, Heath J considered several cases New Zealand's cases on the methods and approaches taken to decide whether a particular behaviour constituted tax avoidance. To a significant degree, Heath J looked at the *Penny and Hooper* case due to the similarities of the facts from the two cases. However, a difference between the two cases was observed in paragraph [71] where it states that "this was not a case in which a reduced salary was deliberately paid. Rather, it was a case in which salary was not paid because the company lacked the funds to do so."

Apart from considering the similarities this case shares with *Penny and Hooper*, the decision reached were based on two other grounds. First, Heath J considered that, at the time the structure was implemented, "there was a realistic expectation of sufficient profit to pay a salary to White [the appellant], from which tax would be paid" (*White* HC, paragraph [74]). Second, as seen from both the *Ben Nevis* and the *Glenharrow* cases, the 'purpose' and 'effect' aspects were revisited. In paragraph [75], Heath J states "while the *effect* of the arrangement was (for unforeseen reasons) to negate the need for White to pay income tax, its purpose was not to obtain an impermissible tax advantage." Therefore, since Heath J held that the arrangement did not constitute tax avoidance behaviour as it was neither artificial nor contrived, tax avoidance is not present. Regardless of the outcome of the case, Coleman's (2011) online blog believes this case to be a "good example of the fact based approach being used to deciding if tax avoidance is present or not."

White is currently being appealed by the Commissioner of Inland Revenue, and while Coleman (2011) suspects *Penny and Hooper*'s Supreme Court decision would be "influential in determining whether the appeal is maintained," there are still some factual differences between the two cases.

The main difference between the two cases is the importance and need to examine the dominant purpose behind the artificially low salary level that was allocated to the taxpayers. In the Supreme Court judgment of *Penny and Hooper*, the emphasis was placed on the fact that even though the formation of the business structure was perfectly legal, the allocation of the salary level was artificial and contrived. This then led on to the decision that Messrs Penny and Hooper were actively involved in a tax avoidance arrangement. On the other hand, it is plausible for *White*'s case to not be a tax avoidance matter as the allocation of either low or no salary levels were due to the fact that the business was not operating successfully (unexpected losses), and therefore, the inability of the business to pay White at the expected market rate. It was stated in the Supreme Court judgment of *Penny and Hooper* that the critical question to ask is *why* the allocated salary was at a particular level on a particular occasion (see paragraph [34]) in order to assess whether tax avoidance behaviour was involved.

As a result, it is possible that the Court of Appeal for the *White*'s case will need to make a distinction between the *purpose* and *effect* for the formation of the new business structure, and decide upon whether the 'salary' and 'tax savings' issues are the dominant purpose for the transformation in the business structure. In addition, it is important to note that this case did not involve complicated transactions, such as, the advancement of funds, as seen in *Penny*'s situation, which could be "an indicator of tax avoidance" (*Penny and Hooper*, Supreme Court, paragraph [19]).

However, there is the possibility that *White*'s appeal may find that the transformation of the business structure was implemented around a sensitive time when the individual income tax rate had been increased from 33 cents in the dollar to 39 cents in the dollar in April 2000. Although the transformation was around two years since the tax rate was changed, it is still likely to be argued that tax savings were not merely incidentals, and therefore, could

be found to be a part of the tax avoidance arrangement. To add to the likelihood of *White* being deemed to have been associated with a tax avoidance arrangement, the argument that the change in business structure was to gain protection from negligence claims from patients may not be suffice (as seen in the Supreme Court judgment of *Penny and Hooper*). This is because of the accident compensation scheme and insurance cover that are already available should a claim be made against the taxpayers.

Therefore, in light of the similarities this case shares with *Penny and Hooper*, it is still likely that the appeal by the Commissioner to the Court of Appeal will be maintained (but not necessarily succeed), especially when Inland Revenue is beginning to 'target tax dodgers' where new or improvised business structures have been formed to reduce their income tax obligations (for example: see Thompson, 2011).

3.2.4 Alesco New Zealand Ltd and Ors v Commissioner of Inland Revenue [2011] HC AK CIV-2009-404-2145

Following the success of *Ben Nevis* and *Penny and Hooper*, *Alesco* is another tax avoidance case that has attracted a high level of attention from the authorities, tax practitioners, researchers, and ultimately, taxpayers. Unlike other tax avoidance cases, this is a trans-Tasman case involving an Australian (parent) company (Alesco Corporation) purchasing two New Zealand businesses by using a debatable funding structure called "optional convertible notes" (OCNs, the "Notes") through Alesco NZ Ltd. (a subsidiary of Alesco Corporation).

Each Note contained both a debt and equity component and although "there was nothing artificial about the acquisitions or the way in which Alesco Corporation used the money to finance them" (*Alesco* HC, paragraph [10]), the focus of issue was on whether Alesco had a sound commercial reason to claim the interest deductions when no money was physically payable by Alesco through this particular transaction. It is understood that this

structure was chosen by Alesco's tax advisors because it was believed that the use of the OCNs would be the most tax-effective way for inter-company financing arrangements (see paragraph [12]).

It was contended by the Commissioner that the arrangement was both "artificial" and "contrived" (*Alesco* HC, paragraph [14]), but Alesco argued that it was not a tax avoidance arrangement as "the financial arrangement rules are designed to deal with a transaction of this type [and] the Notes complied strictly with those rules" (*Alesco* HC, paragraph [44]).

The Commissioner accepted that "Alesco NZ Ltd. complied to the letter with the financial arrangement rules and the methodology for calculating a notional interest component...but such compliance merely provides the jurisdictional foundation for engagement of the general anti-avoidance provisions…" (*Alesco* HC, paragraph [41]). This again raises the difficulty surrounding how tax avoidance may be perceived as it was stated in paragraph [85] of *Alesco*'s judgment that "a taxpayer may undertake a transaction (or a series of transactions) that fall within specific provision of the income tax legislation, yet still fall foul of the general anti-avoidance provision." As with the majority decision in *Ben Nevis*, it is believed that if an arrangement falls outside Parliament's contemplation, then it will be deemed as a tax avoidance arrangement, and this can therefore be seen as a characteristic associated with the concept of tax avoidance itself.

Considerations such as the *motive* of the arrangement, and the *merely incidental* from the transaction were evident in the judgment. First, the Notes were considered to have been chosen with the ultimate goal of obtaining tax advantages, and thus, not considered to be merely incidental (see paragraph [93]). Second, it was held that at the time the Notes were issues, there was no commercial purpose for the transaction, and "unlike an arm's length transaction, there was no negotiation [on the terms associated with the issuing of the Notes]"

(*Alesco* HC, paragraph [113]). As a result, the process was considered to be artificial and "no more than window dressing to make the transaction look more justifiable from a commercial perspective" (*Alesco* HC, paragraph [114]).

Therefore, despite Alesco's compliance with the black letter of the law, the lack of commerciality in the arrangement constituted it as being tax avoidance behaviour. This is because the tax advantages gained were outside Parliament's contemplation. This case considered aspects from *Penny and Hooper* where it confirmed that a tax avoidance arrangement could either be found in an individual step or in a number of steps depending on the commercial reality of the step taken by the taxpayers. Although no explicit definitions are formed by the Judiciary within the judgment, it is clear that the general anti-avoidance provision is a benchmark for assessing cases of this nature. In addition, considerations on the commerciality of the transaction taken by taxpayers and whether it falls within Parliament's contemplation are all crucial factors that can enhance our understanding of what may be viewed as tax avoidance. It is believed that Alesco New Zealand Ltd. is likely to appeal against the judgment as it was ordered to repay the tax that was initially 'saved' through the use of OCNs.

Having gone through four recent tax avoidance cases from New Zealand, there appears to be a general 'trend' where the outcome of the case is dependent upon a list of factors. That is, after considering section BG 1 of the ITA 2007 (or earlier equivalent provision), the Judiciary focuses on the importance in determining whether an 'arrangement' exists, and if so, the *purpose* and *effect* of an arrangement are assessed to determining whether tax avoidance behaviour is present. The various approaches and principles adopted in existing cases also act as an important foundation as it contributes to how the decisions are reached in courts. Therefore, the steps taken from these four cases will form as the base of discussion when more tax avoidance cases are examined in Chapter 6.

3.3 Tax Evasion Cases[15]

As opposed to the extremely blurred sub-category of tax avoidance, the ability to distinguish what tax evasion behaviour incorporates is less complicated in general. However, there are still an unsurprisingly large number of cases within this sub-category because taxpayers are still willing to take the risk of not meeting their tax obligations, and thus challenging the applicable tax regulations. It is evident from a number of studies (for example: see a detailed summary of a selected number of studies compiled by Gupta, 2006) that tax evasion, when compared against other criminal activities, is not perceived as a particularly serious type of crime.

In New Zealand, there are two types of penalties that can be imposed for tax evasion. First, there is the civil penalties regime, outlined in sections 141A to 141E of the TAA 1994. The civil matter of tax evasion ranges from not taking reasonable care (20 percent penalty) to evasion or similar act (150 percent penalty). Ascroft (2010, p. 24) describes the civil regime as an approach to "encourage timely payment and to promote settlements, rather than a costly dispute process." In order to escape civil penalties, the burden of proof is on the taxpayer, where they must show, based on the balance of probabilities, to the Commissioner, that they are correct.

In contrast to the civil penalties regime, the criminal penalties regime is set out in sections 143 to 143B, where each of the three offences carry substantial fines (up to $50,000), and under more serious circumstances, a term of imprisonment (or both). However, only section 143B can lead to a term of imprisonment. First, there is the 'absolute liability offences' category of offence, dealt with in s143 and it is one where failure to do the specified action is sufficient proof that an offence has occurred, without the need to prove

[15] Unless otherwise stated, all references to the sections under Chapter 3.3 and its sub-parts are made to the Tax Administration Act 1994 ("TAA 1994").

taxpayers' knowledge or intent (Ascroft, 2010). The next category is related to 'knowledge offences', and is dealt with in s143A, where it is deemed to have been breached when a taxpayer deliberately (or knowingly) breaches a tax obligation (Ascroft, 2010). The last category is called 'evasion or other offences',[16] and it is dealt with under s143B. The IRD's webpage defines this category as behaviours involving "deliberate actions to cheat the revenue [and] may include a taxpayer obtaining refunds knowing that he or she if not lawfully entitled to them and knowingly not accounting for tax deductions to the Commissioner." Above that, an element of intent, as well as the knowledge of the tax law, are seen as 'pre-determinants' for deciding whether a particular behaviour amounts to tax evasion (Gupta, 2006).

It is important to understand that whilst evasion is the most serious form of offence, it is also crucial to realize that tax evasion itself is an offence under s143B (2) (Ascroft, 2010). The word 'evade' is not defined separately in the Act itself but common characteristics such as, 'a deliberate act', 'deception' and 'an element of intent' has usually been associated with evasion behaviours (as described in Chapter 2.3.1).

The following section will consider a selection of recent New Zealand cases associated with the criminal penalties under ss143-143B. The cases considered within this section were all appealed, either by the taxpayer or the Commissioner, where there was an objection or disagreement concerning either the conviction or sentence imposed by a lower court.

[16]The different forms of what is classified as 'similar offences' are outlined in s143B (1) of the TAA 1994. A brief summary on the categories for criminal penalties can be found at: http://www.ird.govt.nz/technical-tax/standard-practice/shortfall/sps-inv-225-criminaloffence-evasionorsimilaroffences.html

3.3.1 R v Geoffrey Martin Smith CA [2008] CA275/2008 NZCA371

Sections 143A and 143B from the TAA 1994 were breached by Smith and his wife as they had knowingly failed to pay PAYE and had the intention of evading such payments (including GST returns). An appeal to the Court of Appeal (COA) was made by Smith against both of his conviction and his sentence where he thought it was "manifestly excessive" (*Smith* COA, paragraph [2]). It was alleged by Smith that since the Commissioner did not know of the 'actual' amount that was undeclared and unpaid, it would be impossible for an accused person to invoke the defence available under s143A (4). However, both Judge Maze[17] and Chisholm J[18] pointed out that there is no requirement for the actual amount of unaccounted PAYE to be known by the Commissioner before an offence is deemed to have been committed. Paragraph [15] of the COA judgment stated that Smith's interpretation would "defeat the statutory purpose in situations, which by no means uncommon, where there are poor records or, indeed, where records have been destroyed or fabricated." This then led on to the argument that it "could not have been Parliament's intention that the Crown's inability to prove the particular amount would provide an escape route for persons facing a charge under s143A (1) (d)" (*Smith* COA, paragraph [15]).

In addition, it was pointed out that if there was a disagreement in the amount of deductions/taxes due, "it will be for the taxpayer to satisfy the Court that his or her calculation is right" (*Smith* COA, paragraph [17]). As a result, the same principle can be applied to the dispute on GST returns where the actual amount payable does not need to be known by the Commissioner before it deems an offence has been committed.

[17] A Judge from the Hamilton District Court.
[18] A Judge from the Court of Appeal.

The appeal was dismissed, and Chisholm J concluded that this "was serious offending over a prolonged period (approximately five years) involving a substantial amount of unpaid tax" (*Smith* COA, paragraph [38]). The basis of this judgment highlights the severity of penalties that can be imposed on taxpayers who have the intention to evade, but does not provide an explicit definition of what evasion may be (other than making references to s143B). In particular, if the duration of offending is prolonged, and the financial advantages gained are significant, then they would be regarded as aggravating factors to the penalties imposed on the taxpayers as they would have had plenty of time to make appropriate amendments if they had no intention of breaching s143B.

3.3.2 The Commissioner of Inland Revenue v Duncan Fraser Dempsey [2010] HC WN CRI2010-485-89

This was an appeal made by the Commissioner to the High Court (HC) where the Commissioner disagreed on the sentence imposed by the District Court Judge because he believed that the sentence was manifestly inadequate as the taxpayer had pleaded guilty to accounts of evasion under s143B.

Dempsey was an architect/draftsman who was the sole director of Inscape Design Limited. However, between 2004-2005, he had "failed to file personal income tax returns and income tax returns on behalf of the company" (*Dempsey* HC, paragraph [4]). This constituted as an offence under s143B (1) (b) (f). Dempsey accepted that there was a breach in tax law but he denied that his actions were intentional due to the decrease in value of work in his company in recent years, which had a lead-on effect that he could not afford to hire an accountant. In addition, he stated that he was under the assumption that since his business was failing; he was not in a position to have tax liabilities payable. The Judge from the District Court accepted the statement that "the respondent simply did not have the money to

pay an accountant as his company was owed a number of substantial debts which it could not collect" (*Dempsey* HC, paragraph [8]).

It was noted that the respondent had a poor compliance rate before this offence, but as he "did not appear to have obtained any assets through his offending" (*Dempsey* HC, paragraph [9]) and "did not use the tax money to support a lavish lifestyle…" ((*Dempsey* HC, paragraph [16]), Ronald Young J (HC Judge) perceived these to be attributes of a more 'lenient' sentencing for Dempsey.

Unlike *Smith* (2008) where there was no reference on the distinction of the seriousness of evasion behaviour, it was implied here that there was a difference in evasion between "deliberate misleading" and in this particular case, a "bumbling incompetence" (*Dempsey* HC, paragraph [16]), as demonstrated by the taxpayer. Nevertheless, it was still an offence under s143B and the taxpayer cannot be excused from the offence, but it may lessen the "impact from a sentencing perspective" (*Dempsey* HC, paragraph [16]).

Therefore, as with the approaches taken in tax avoidance case law scenarios, an important factor to be established by the Courts is the need to consider *why* the offence has occurred and assess whether the offence was for the taxpayers to gain personal financial advantages or whether some other (indirect) reason has led to the breach of the relevant sections. Although consideration on the time frame in which a shortfall of taxes paid was taken into account when determining appropriate penalties in *Smith* (2008), this case did not place a dominant focus on the timeframe in which the years were in question. This then raises the issue of whether there is a pre-set standard as to what factors[19] have to be taken into account when determining appropriate penalties, and how the concept of tax evasion should be defined in case law.

[19] Factors may include, for example: the time frame, whether the financial gains were used to support a better lifestyle, the amount of taxes evaded, and so on.

3.3.3. Tonks v R [2011] CA 749/2010 NZCA 252

This appeal to the Court of Appeal (COA) was mainly based on why the taxpayer was unsatisfied by his sentence as the Crown "did not prove beyond reasonable doubt that he acted knowingly and with the intention of evading the assessment or payment of tax" (*Tonks* COA, paragraph [6]). The issue arises due to Tonks' belief that the salary paid to him should not be taxed and thus, without the need to file personal tax returns. Based on his argument, he is just receiving a 'reward' for his work as he is not a "slave" (*Tonks* COA, paragraph [8]), and therefore, should be compensated for his contributions at work. After several attempts of contacts between him and the Commissioner, Tonks finally declared his income. However, the Commissioner had strong reasons to believe that the declared amount was significantly lower than the actual amount Tonks had actually earned (see *Tonks* COA, paragraph [16]).

Tonks had accepted that his behaviour had been "obstructive" (*Tonks* COA, paragraph [33]) but he argued that he "genuinely and honestly believed the payment of tax was voluntary and that he was not obliged to pay tax or to comply with the Commissioner's requests for information with regard to his tax affairs" (*Tonks* COA, paragraph [33]). However, this argument was rejected by the COA based on three grounds. First, Tonks had advised his company's accountant (Mrs. Varnam) to amend the company's returns in order to show a lower level of profit, and therefore, the amount of tax liabilities payable. Second, Mrs. Varnam had previously advised him to pay tax on both his personal income and to file the company's required returns (see paragraph [37]).

Both of these two reasons acted as confirmation that Tonks did have knowledge of his obligations prior to the court hearings. Last, the amended personal tax returns later filed by Tonks contained false information; this provides further assurance to the Courts that Tonks had *knowledge* on his obligation to pay tax, but he had the "intention to evade the assessment or payment of income tax" (*Tonks* COA, paragraph [36]).

Unlike the two previous cases described earlier where only references to s143B were made, this case explicitly outlines the meaning for the concept of ‘evasion’. It is stated in paragraph [34] that the word “evade” is “associated with the expressions “attempts to evade” or “does any act with intent to evade” [which can include] and element of intent, an intention to endeavour to avoid payment of tax known to be chargeable” (*Tonks* COA, paragraph[34]). In sum, a person “can only evade that which he or she knows to be his or her obligation” (*Tonks* COA, paragraph [35]). This understanding for evasion can be said to be a modified version of what is stated in s143B of the Act where factors of ‘knowledge’ and ‘intent’ are important factors to consider before establishing whether the taxpayers have breached any tax regulations. As it may sometimes be difficult to determine whether knowledge and intent are present, the facts of the case presented also act as a primary source of evidence for the Judiciary to conclude whether the evasion or similar acts of behaviour are present. Furthermore, these factors act as important keywords for a comprehensive definition for tax evasion.

Chapter 3 has reviewed a selection of recent tax avoidance and tax evasion cases from New Zealand where it provides an example of the scenarios that are presented to the Courts. More tax avoidance and tax evasion cases from New Zealand will be further discussed in Chapter 6, where it will examine a wider variety of approaches and principles that have been adopted by the Judiciary under different circumstances in order to establish the definitions for the relevant concepts relevant to this study.

4.0 Methodology

4.1 Introduction

Due to the complexity of tax law (White, 1990) and the objectives set out for this study, a qualitative research method involving document analysis has been utilized. This method was selected so that the study was able to extract information from a wide variety of resources where it would provide the relevant information concerning behavioural tax compliance and non-compliance. Apart from the complex taxation rules and regulations, the main reason for opting for a qualitative based research method is because it involves "the systematic collection, organization, and interpretation of textual material derived from talk or observation" (Malterud, 2001, p. 483). The costs incurred during the process of data research and collection was around $300, and a significant amount of this cost was associated with printing and photocopying of the data resources collected.

4.2 Method

The various definitions of tax compliance, non-compliance, and their sub-categories have been gathered from various data sources. The forms of data information collected include: journal articles, books, conference papers, research papers, newspaper articles, and web pages. The inclusion of a number of data sources were selected to examine how the definitions have changed (and sometimes remained constant or similar) over the years. In general, published journal articles would be deemed to be a more reliable and respectable source of data information when compared against other data sources, such as, web-pages, but by examining a variety of sources has allowed this study to produce a more comparable set of results. The reason for believing that journal articles are considered to be a reliable form of resource is because of the time and effort that have been put into the articles

themselves, and that is not usually expected on web pages from the internet. Nevertheless, it is highly probable that specific references gathered for this study were written for "some specific purpose and some specific audience" (Yin, 2009, p. 105), but it is believed that this obstacle was overcome by including a variety of data sources during the data collection process to ensure that an unbiased, yet, critical analysis of the researched results are reflected in Chapters 5 and 6, respectively.

The approach taken to gather the definitions from various studies would be classified as document analysis. This method has been described by Slarkin's (2010) web page as a "technique used to gather requirements during the requirements elicitation phase of a project [to] extract pieces of information that are relevant to the current project [that will be incorporated into the current study]." The use of documents as a source of evidence can be seen as providing a solid foundation for "other specific details to corroborate information from other sources, [leading to possible] inferences that can be made from documents" (Yin, 1994, p. 81). This approach intends to provide a "stable, unobtrusive, exact, and broad coverage [of data from various sources to be combined to produce a concise set of results]" (Yin, 2009, p. 102).

The date of publication on the data sources was not limited as it was an objective of this study to compare and contrast the many forms of definitions that have been established between studies over the years. As the topic of behavioural tax compliance is fairly widespread, several studies have placed a focus on the variables that influence the behaviours of tax compliance and non-compliance, while other studies have focused on case/experimental scenarios where they seek to test whether taxpayers change their standard of compliance behaviour under different circumstances. However, it is due to the different emphasis of those studies that has allowed for this study to collect the various forms of

definitions that have been adopted over the years in order to produce a critical review based on the objectives set out in Chapter 1.

The nature of some studies has made it necessary that they were excluded from this research due to time and resource constraints, as will be described in more detail in Chapter 8. The studies excluded from this study are mainly finance or economics based papers where their focus differs to a significant degree from the objectives set out in this study. However, a limited number of finance and economics based papers were still looked at if their methodology of study had not been significantly focused on mathematical functions. In addition, to reduce the risks associated with translation, non-English texts have also been excluded. Despite those exclusions, there are still a significant number of studies that were available to be examined for this study to provide a generalizable set of researched results.

The second part to the data collection method involved the gathering of case law judgments in order to assess the similarities and differences on the principles and approaches taken to arrive at a decision as to what is meant by the concepts important to this study. In order to limit the scope of research, only case law from New Zealand has been considered for this study. Both web pages of commentaries and online case judgments have acted as important sources of data evidence required to draw generalizable conclusions on the approaches and principles that have been adopted by the Judiciary over the years.

As opposed to not clearly limiting the year of study for existing literature, the year of the case law has been limited to a significant extent. Due to the number of cases within the area of behavioural tax compliance and non-compliance, it was necessary to draw clear boundaries that this study would only focus on recent cases from New Zealand, and also, only cases that originated from around 2008. The focus on recent cases meant that the approaches and principles taken by the Judiciary are reflective of the current rules and

regulations. In addition, the focus on recent case law can potentially reduce the risks of "economic, technological, social and political changes" (Richardson, 2004, p. 301) that may occur over time where it may have an influence on the nature of researched results obtained for this study. Thus, this approach has allowed for a more detailed analysis on the current approaches and principles taken by the Judiciary under case law scenarios where the researched results would reflect aspects of relevancy and practicality.

The majority of New Zealand's case law was gathered from the Brookers Online database where keywords such as 'tax avoidance' and 'tax evasion' were used to gather the relevant cases. Most New Zealand cases were gathered from the Courts of New Zealand web page, while summaries of recent court decision were located from the Inland Revenue Department's web pages. Additional information on the facts of the cases were usually extracted from existing literature where it provides detailed commentaries and discussions on the approaches and principles taken; as well as decisions reached in courts.

A considerable amount of time had been spent on the internet searching through databases such as Google Scholar, JSTOR, Science Direct, and BrookersOnline in order to collect resources from both international existing literature and New Zealand case law. Various keywords have been used to allocate the relevant studies and case law judgments. Keywords such as 'tax avoidance' and 'tax evasion' produced the greatest number of results for existing literature. In addition, whilst searching for sub-categories within tax compliance and non-compliance, keywords including: 'tax compliance', 'tax non-compliance', 'tax minimization', 'tax planning', 'creative compliance', and 'over-compliance' were also used to allocate the relevant studies. Unfortunately, some of those search phrases were less successful, and this was especially evident in the area of research on 'creative compliance' and 'over-compliance, as the area of research around these keywords are currently very limited from a research perspective. Apart from gathering data online, loans from libraries,

either from the University of Canterbury's libraries or from various public libraries was also necessary as some older articles and books were unavailable online.

In addition to the examination of existing literature and case law, a letter was sent to the New Zealand Commissioner of Inland Revenue (hereafter referred to as the "Commissioner") requesting his views and comments on the current principles and approaches adopted in case law scenarios by the Judiciary. The letter sought his views on the appropriateness and conclusiveness on the current state of the definitions for tax compliance, non-compliance, and their relevant sub-categories. The overall objective for sending the letter was to buttress the main findings from the case law collected for this study in order to produce a more comprehensive set of results as to how the concepts of tax compliance and non-compliance are treated under case law scenarios.

As the letter to the Commissioner did not intend to seek confidential information or for the respondent to act outside his ordinary obligations, a formal approval from the University of Canterbury's Human Ethics Committee was not required. A copy of the letter that was sent to the Commissioner can be found in Appendix F. The letter to the Commissioner was posted on 10 January 2012. A follow-up email was sent to the Commissioner on 23 February 2012. Unfortunately, no response was received from the Commissioner at the date of submission.

Finally, to conclude the findings for this study, a letter was also sent to two tax practitioners around New Zealand.[20] The objectives of the letter included gathering their views and opinions on the current approaches taken by the Judiciary under case law scenarios, as well as collecting their perspectives on the issues of behavioural tax compliance. In

[20] The two tax practitioners (tax barristers) were selected as they have vast experience in tax avoidance and litigation matters. It was hoped that through their knowledge and experience around behavioural tax compliance and non-compliance, the response letter from them would be both informative and invaluable for the purpose of this study.

addition, the letter also intended to collect ideas as to how they would define the concepts (and sub-concepts) of tax compliance and non-compliance. The letter began with an introduction into the area of research, followed by questions where they are divided under one of the five main headings. The tax practitioners were given an information sheet which outlined a brief summary of the study, as well as their rights and what was expected from them. In addition, they were also asked to sign a consent form where they formally give their permission for including their contributions to this study. The approved letter from the Human Ethics Committee; as well as the information sheet and the letter sent to the tax practitioners can be found in Appendix D and E, respectively.

Although the letter did not intend to seek confidential information, nor did it require the tax practitioners to act outside their normal duties, a low-risk application was still made to the University of Canterbury's Human Ethics Committee. The application was made to prepare for a possible interview if the tax practitioners had preferred to answer the questions in person. Approval from the Human Ethics Committee was received on 9 January 2012. Due to the sensitivity of the research topic, the tax practitioners' identities have been kept confidential within this study; and so they will be referred to as tax practitioner A and B. The letter to the tax practitioners were posted on 30 January 2012. A follow-up email was sent to the tax practitioners on 23 February 2012. The response letter from tax practitioner A was received on 27 February 2012. The response letter has provided an interesting perspective on the matter of tax compliance and non-compliance. Details of the response will be discussed in Chapter 6. Unfortunately, no response was received from tax practitioner B at the date of submission.

4.3 Analysis

Within each of the existing studies gathered, emphasis was placed on how the concept(s) were either implicitly or explicitly acknowledged or defined by the researcher(s). For the studies that did not clearly state what the concepts had intended to accommodate for the actions of within their particular study, a separate discussion can be found in the next chapter in order to observe possible reasons for the case. In addition, the inclusion of those studies that do not define the concepts is intended to examine whether possible patterns may be found between them so that they can lead to some possible explanation as to why particular studies do not explicitly define the concepts of tax compliance and non-compliance. This study contains references of existing literature and case law up to and including 31st December, 2011.

A separate table is used for each of the concepts of tax compliance, non-compliance and their sub-categories to show how the definitions have been formed over the years between different studies. The five tables are namely: tax compliance, tax non-compliance, tax avoidance, tax evasion and over-compliance. These five tables represent the five main concepts that are of particular importance for this study (see Chapter 5).

The order of the definitions within each of the tables is based on the chronological order of the publication date for the studies. In addition, to allow for a more detailed examination, each of the definition is measured against two or three factors to determine the definitions' descriptiveness and comprehensiveness. The two or three factors were selected by extracting distinctive characteristics from the definition gathered from Chapter 2 and are used as they represent the foundation of the research process for this study. Although they may not be as comprehensive as some of the definitions gathered after the initial stage of research, they remain as the skeleton of the research process when more definitions were

collected for this study. The factors extracted from each of the definitions for the concepts are described in more detail in Chapter 5 under the appropriate headings.

As for the chapter concerning case law, the analysis has been divided between two sub-sections, namely, tax avoidance and tax evasion. This allows for a clear discussion on the cases that are of non-criminal (tax avoidance) and criminal (tax evasion) nature. The details of the facts from the cases were not examined individually. Instead, the primary emphasis has been placed on the approaches and principles taken by the Judiciary whilst determining the outcome of the case. That is, rather than providing a detailed summary on the facts of each case, this study has grouped the main points considered by the Judiciary when determining whether a particular behaviour is tax avoidance or tax evasion. In rare situations where an explicit definition has been provided for the concepts of tax avoidance and tax evasion (that is, over and above the definitions provided for in the legislation), the definitions have been inserted in the appropriate paragraphs.

In addition, as part of the analysis on existing literature and case law, aspects of the response letters from tax practitioner A are included in the discussion of the research results in Chapter 6 and the responses received from tax practitioner A can be found in Appendix E.

5.0 A Critical Review of the Research Results- Existing Literature

5.1 Introduction

Researched results from existing literature and case law gathered for this study have highlighted the difficulties and challenges researchers have faced over the years in order to enhance our understanding on the key concepts of behavioural tax compliance and non-compliance. Not only did the definitions vary between the date of publication, the nature of study and the scope of study, but the definitions also varied between the researcher's own interpretations to the key concepts within their studies. It is therefore due to these factors that we continue to have slight variations in the definitions for the concepts of tax compliance and non-compliance. As well as the explicit definitions, some studies have outlined several examples to facilitate the explanation as to what those concepts may accommodate, but clearly, this approach is still insufficient to fully capture what the essence of what the concepts may entail.

However, it is evident that there are some definitions that are more logical and more comprehensive than others, but without a doubt, the majority of the definitions to date still lack the consistency that is expected from defining a certain concept/behaviour of tax compliance and non-compliance. Although some distinctions between the definitions for the concepts may seem minor, it is still imperative that a distinction is made between the 'layers' or 'sub-categories' of tax compliance and non-compliance, especially given the unwelcome state the governments are experiencing due to the increase in taxpayers involving themselves in acts to avoid (or reduce partially) their 'true' tax obligations. Nevertheless, it is because of these non-compliant activities demonstrated by taxpayers that lead to our widened

understanding of what is acceptable and what isn't through the cases that have been presented to the courts over the years.

As with Chapters 2 and 3, research results have also been divided into two separate chapters. Chapter 5 examines the results from existing literature as to what has been established over the years on the concepts of tax compliance and non-compliance. A table for each of the relevant concepts has been inserted to provide a summary of how the studies have defined the concepts (either explicitly or implicitly) within their particular studies. Chapter 6 then focuses on how New Zealand's case law have dealt with the various forms of non-compliance behaviour (predominantly tax avoidance and tax evasion) through the analysis of the approaches and principles adopted by the Judiciary. Within the examination of the approaches and principles taken by the Judiciary, emphasis has been placed on whether the definitions of the concepts have been made clear as to what acts constitute as either tax avoidance or tax evasion behaviour.

5.2. Behavioural Tax Compliance Literature

Despite the various forms of definitions for the concept of tax compliance, it has generally been agreed in studies that 'tax compliance' portrays the idea that taxpayers do comply with the relevant legislation when meeting their tax obligations. This form of understanding is evident from many studies, including the studies conducted by: Jackson and Milliron (1986); Attwell and Sawyer (2001); Richardson and Sawyer (2001); and Verboon and van Dijke (2007). However, the aspect of 'complying with relevant legislations' should only be considered as the 'skeleton' of what tax compliance behaviour truly encompasses. Because of the complexities in tax laws, Devos (2004, p. 224) believes "there is not a standard all-embracing definition of compliance [that can be] adopted across all tax compliance studies."

The definition adopted by the United States Internal Revenue Service (IRS) is slightly more descriptive, in the sense that it covers more than just one aspect of what the concept of tax compliance entails. Their definition of tax compliance is when taxpayers have met the "reporting requirements [and] that the taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations and court decisions applicable at the time the return is filed" (Richardson and Sawyer, 2001, p. 142). This definition covers three main aspects: (A) the filing of accurate returns, (B) at the proper time, and (C) in accordance with relevant legislations. These three characteristics have been used as benchmarks to measure the effectiveness and comprehensiveness of the definitions listed in the table below. The purpose of this is to evaluate how the definitions of the concept of tax compliance have changed (or remained fairly constant) over the years and whether additional, but often ignored aspects, may have been introduced into particular tax compliance studies over the years.

Table 1: Definitions of 'Tax Compliance'

Details of Study	**Definition from study**	**Factors considered**			**Additional Notes (where applicable)**
		Accurate returns	*Proper time*	*Accordance with rules*	
Jackson and Milliron (1986)	Taxpayers filing accurate, timely and fully paid return without IRS enforcement efforts.	√	√		Former definition used by the IRS.
Roth et al. (1989)	The taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.
Jenkins and Forlemu (1993)	The timely filing and reporting of required tax information, the correct self-assessments of taxes owed, and the timely payment of those taxes without enforcement action.	√	√		Accommodates possible 'layers' of compliance.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Accurate returns	*Proper time*	*Accordance with rules*	
Hasseldine and Li (1999)	The taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.
Franzoni (2000)	Compliance with the law typically means: (i) true reporting of the tax base, (ii) correct computation of the liability, (iii) timely filing of the return, and (iv) timely payment of the amounts due.	√	√	√	A similar definition adopted by both the IRS and the IRD.
Attwell and Sawyer (2001)	The taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.
Richardson and Sawyer (2001)	The taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.
James and Alley (2002)	A continuum of definitions [which] ranges from the narrow law enforcement approach to wider economic definitions and onto versions of taxpayer decisions to conform to the obligations of tax policy and co-operation with the society.			√	Acknowledges the existence of having more than one standard definition for tax compliance, that is, the 'layers' of compliance.
Braithwaite (2003b)	The extents to which taxpayers do what is expected of them and are prepared to cooperate with the authority.			√	
Tan and Sawyer (2003)	The taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Accurate returns	*Proper time*	*Accordance with rules*	
Devos (2004)	The taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.
Devos (2006)	Compliance with reporting requirements, meaning that, the taxpayers files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue Code, regulations, and court decisions applicable at the time the return is filed.	√	√	√	The definition used by the IRS.
Burton (2007b)	There are different forms of compliance. Taxpayers at the base of the compliance pyramid are said to 'voluntarily' comply because they submit to or even adopt the compliance culture of the tax administration, while those at the pinnacle of the pyramid are subject to enforced compliance.				Takes into account the 'layers' of tax compliance.
Verboon and van Dijke (2007)	The willingness of people to comply with tax authorities by paying their taxes.			√	Considers that some compliance may not be voluntary.
U.S. Department of the Treasury (2009)	The Internal Revenue Code places three primary obligations on taxpayers: (1) To file timely returns (2) To make accurate reports on those returns; and (3) To pay the required tax voluntarily and timely. Taxpayers are compliant when they meet these obligations (without direct IRS intervention).	√	√	√	From a document prepared by the U.S. Department of the Treasury themselves.
Kirchler and Wahl (2010)	Leads to the honest payment of taxes, the underlying intentions of the behaviour can either by voluntary or enforced by authorities. [It is] the most inclusive and neutral term for taxpayers' willingness to pay their taxes.	√			Considered the possible 'layers' of compliance.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Accurate returns	*Proper time*	*Accordance with rules*	
Murphy (2010)	Seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.	√	√	√	Tax compliance should not include instances where there is an over-payment of taxes.
Prince Rasaq Kunle Quadri et al. (2010)	Encompasses all activities necessary to be carried out by the taxpaying public in order to meet the statutory requirements of tax law. This includes the preparation of tax returns that must be filed by individuals and organizations.	√		√	
IRD (2011g)	Compliance is when: -everyone pays and receives the right amount [of tax] -we [the IRD]receive the right information at the right time -everyone files and pays on time -we [the IRD] provide confidence and certainty to our customers.	√	√	√	This definition takes a similar approach from the IRS's definition of tax compliance.

5.2.1 The 'layers' of tax compliance

The accommodative nature of the tax compliance definition adopted by the IRS has been cited in a number of studies, such as: Roth et al. (1989); Hasseldine and Li (1999); Attwell and Sawyer (2001); Richardson and Sawyer (2001); Tan and Sawyer (2003); Devos (2004) and Devos (2006). Before this definition was adopted, the previous definition of tax compliance by the IRS used to be, "[when taxpayers file] all accurate, timely and fully paid return without IRS enforcement efforts" (Jackson and Milliron, 1986, p. 130). Both forms of these definitions are very descriptive as to what behaviours can be perceived as tax compliance behaviour, but at the same time, both of these definitions have left out the presence of the 'layers' of tax compliance.

Braithwaite (2003a, p. 24) believes that "a definition of tax compliance ideally should be one that captures issues of theoretical importance as well as giving practical direction for measuring the concept." The IRS's definition may have covered the 'theoretical' aspects, but it lacks the part on giving 'direction' as to whether compliance is 'voluntary' or 'enforced'. This seemingly comprehensive approach for defining the concept of tax compliance is evident from a number of studies, for example, the study by Jenkins and Forlemu (1993) does not provide a distinction between voluntary and enforced compliance. That is, taxpayers may have met the three factors from the IRS definition described earlier, but their "motives for compliance" (Kirchler et al., 2008, p. 210) have been ignored. In addition, some studies (for example: Alm et al., 1993 and Prince Rasaq Kunle Quadri et al., 2010) examined the causes and reasons for voluntary compliance, but they do not provide an explicit definition for the concept, nor do they examine the differences between voluntary and enforced compliance.

James and Alley (2002, p. 30) believe enforced compliance to arise in situations when taxpayers comply "because of dire threats or harassment [from the tax authorities] or both," whereas, voluntary compliance is the opposite. It is believed that voluntary compliance can be enhanced in situations where the "taxpayers feel that they have a voice in the way their taxes will be spent…" (Alm et al., 1993, p. 287). In addition to the fairness factor, other behavioural factors described by Jackson and Milliron's (1986) study should also be perceived as influential factors for contributing to the level of voluntary compliance.

In addition, James and Alley (2002, p. 30) raise an interesting idea that enforced compliance cannot be viewed as "proper compliance" due to the involvement of the tax authorities in order to collect its tax revenue. From McBarnet's (2003, p. 229) theory, voluntary compliance can be treated in the same manner as 'committed compliance', as this is when "taxpayers choose to comply willingly [when] faced with a tax bill." On the other hand, enforced compliance may be viewed as 'capitulative compliance', where "taxpayers

choose to comply unwillingly; [that is, they] complain but pay up nonetheless" (McBarnet, 2003, p. 229). That is, they have "no choice but to meet the request [of their tax liabilities due]" (Braithwaite, 2003b, p. 276), or it may be viewed as taxpayers demonstrating signs of tax resistance (Wahl et al., 2010). James and Alley (2002) describe possible audits and fines to be the cause and result of enforced compliance as taxpayers are usually risk averse in nature where non-compliance activities would be kept out of the view of the authority. These factors are not usually included within the definitions of enforced compliance, but they act as the basis of what enforced compliance may entail as these examples enhance our understanding of what we can expect from enforced compliance behaviours. The same approach could be taken for circumstances where a 'universal' definition is to be developed for voluntary compliance as it is evident from the literature gathered for this study that voluntary compliance is compliance without enforcement efforts and is the opposite of enforced compliance.

As opposed to the distinction between voluntary and enforced compliance, Birch et al. (2003) differentiate tax compliance between taxpayers who comply with the 'letter' of the law against taxpayers who are complying with the 'spirit' of the law. An unofficial recognition for voluntary compliance may be seen as taxpayers who have complied with both the 'spirit' and 'letter' of the law, while enforced compliance only roughly equates to taxpayers complying with the 'letter' of the law. It may be argued that it is unnecessary to define tax compliance by distinguishing between complying with the letter and spirit of the law because regardless of what the intention was, taxpayers have met their applicable tax obligations.

Nevertheless, it is still relatively important to define tax compliance in the manner that will be able to differentiate between compliance with the 'letter' and 'spirit' of the law as enforcement efforts made by the government are likely to have an impact on tax revenue and budgetary implications in the long-run. Birch et al. (2003, p. 67) suggest that definitions of tax compliance that do not at least meet the criteria covered by the IRS definition would be perceived as "rather simplistic." The absence of a clearly defined definition for the concept of tax compliance has 'encouraged' more taxpayers to take advantage of the grey areas of tax law, and thus, involving themselves in the exploitation of tax loopholes, leading to the forever-increasing tax gap experienced by governments around the world.

As a result of the inconsistencies and variations that arise between behavioural tax compliance studies, James and Alley (2002) and Kastlunger et al. (2010) have each developed a continuum attributable to the possible 'layers' of tax compliance as opposed to simply defining the concept. According to James and Alley (2001, p. 27), one end of the continuum is the 'narrow' approach, that is, the "law enforcement approach," where it is purely concerned with whether taxpayers comply. In contrast, the other end of the continuum is the 'wider' approach, where it takes into account the possible tax compliance behaviours, and accommodates for the "wider economic definitions" (James and Alley, 2002, p. 27), where it considers various factors that can influence the level of compliance demonstrated by taxpayers.

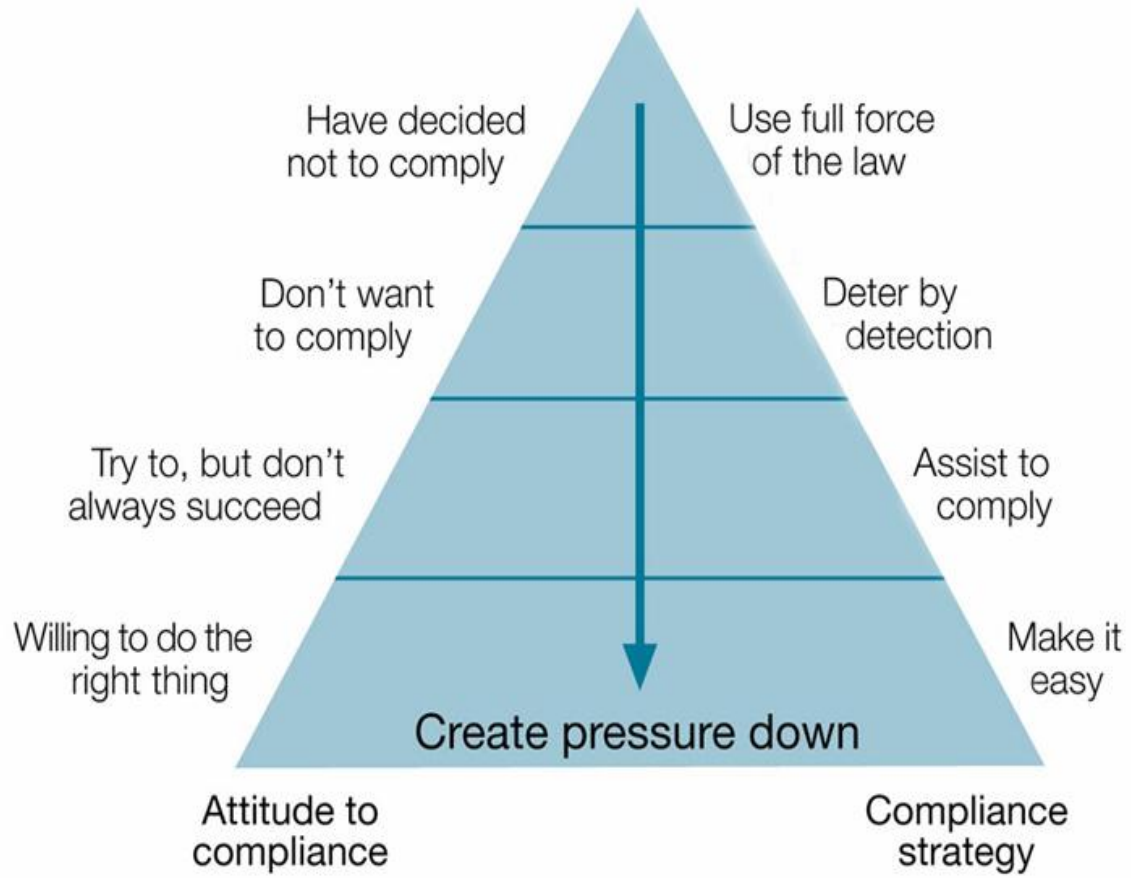
The application of the continuums highlight the issue of whether it is ever possible (and practical) to define the concept of tax compliance in one simple sentence as there are too many factors and variables affecting how tax compliance can or should be defined. In addition, due to the many 'layers' of tax compliance, one may consider it to be more practical to have a definition for each of the 'layers' of compliance behaviour, that is, a different definition is prescribed to 'voluntary' and 'enforced' tax compliance. Consequently, Verboon

and van Dijke (2007) believe that in order to fully capture what the concept of tax compliance incorporates, it is important for researchers to examine *why* taxpayers comply so as to be able to acknowledge the various 'layers' of tax compliance in order to reduce confusion and to enable necessary changes to be made to the tax system to promote (voluntary) tax compliance.[21] Nevertheless, James and Alley (2002) realizes the difficulty of attributing an explicit definition for tax compliance as there may be a difference in the interpretation of what tax compliance behaviour is, and what it may entail. Therefore, in order to adopt a descriptive definition for each of the 'layers' of tax compliance, it is necessary to examine whether external factors, such as the "exchange between the paid tax and performed government services" (Torgler, 2007, p. 74), are equitable when viewed from the taxpayers' perspective as this will have an influence on whether compliance is voluntary or enforced, and ultimately, how 'layers' of tax compliance should be defined.

As opposed to straight definitions or continuums for understanding the concept of tax compliance, the approach taken by the Inland Revenue Department (IRD) is through the adoption of a compliance model (see Figure 1 below). It is a model which evaluates the attitudes and behaviours of taxpayers' compliance in New Zealand (Sung, 2009). The shape of the compliance model is a pyramid. The top of the pyramid consists of the small portion of taxpayers who decide not to comply and the bottom of the pyramid represents the large number of taxpayers who are willing to do the right thing. Although the compliance model does not capture the intent or motive of why a taxpayer complies, it is useful for determining the attitudes of the four main groups of taxpayers when faced with their tax liabilities.

[21] For more details on why taxpayers comply, see McKerchar (2001).

Figure 1: The Inland Revenue Department's Compliance Model[22]



Having considered the influence external variables have on tax compliance behaviour, it may be agreed that the definition of tax compliance adopted by the IRS is currently the best suited representation for the concept, whilst bearing in mind that a continuum exists for the need to differentiate between the 'layers' of tax compliance. Unfortunately, none of the studies in literature gathered have attempted to combine tax compliance and its 'layers' together to form an even more comprehensive definition for tax compliance.

This study agrees with Devos' (2008, p. 3) statement that "there is no standard all embracing definition of compliance adopted across all tax compliance studies." Hasseldine and Li (1999, p. 2) recognize the difficulty currently experienced by researchers as it states that "tax compliance is often a complicated procedure that requires detailed knowledge and

[22]Accessed from: http://www.ird.govt.nz/technical-tax/prosecution-framework/prosecution-framework.html

effort." Having said that, Picciotto (2007, p. 2) states it is also important to be certain that the interpretation and understanding of rules do not differ between the parties concerned.

Therefore, given the current state of the situation, this study supports James et al. (2001, p. 159) remark that "[it is] clear that there are different definitions of tax compliance and different approaches to the issue [due to various factors]." Thus, although a 'universal' definition for tax compliance may not be practical given the current state of what existing literature has examined, it does not imply that the current definitions of tax compliance are inadequate, but rather, more emphasis should be placed on how to objectively determine the 'layers' of compliance, and how they can be defined so that the definition can function smoothly under different circumstances. In addition, in order to define the 'layers' of tax compliance in a 'universal' manner, support from various domains of study (for example, behavioural-based psychological and sociological studies) are also important as they would be able to facilitate and enhance how the different behaviours are recognized under different circumstances. However, it may be unhelpful and unproductive for futures studies to further divide the 'layers' of tax compliance if just a little more confirmation could be reached on the differences between voluntary and enforced compliance and compliance with the 'letter' and the 'spirit' of the law.

5.3. Behavioural Tax Non-Compliance Literature

In the most basic terms, tax non-compliance is the "antithesis of compliance, it represents the failure by a taxpayer to meet all of their compliance obligations in a timely and accurate manner" (Tan and Sawyer, 2003, p. 432). Non-compliance behaviours demonstrated by taxpayers can be said to represent the actions of what compliant taxpayers would not do. Although some taxpayers may get caught and be punished by the authorities for not complying should they get caught, some still attempt to challenge and exploit the loopholes

within the grey areas in the tax system. It has been estimated that the rate of non-compliance grows at a massive 10 percent per annum (Tan and Sawyer, 2003) and at least 50 percent of the taxpayers who file a tax return have in some way engaged in some form of tax non-compliance (Tan and Sawyer, 2003). Because of the growing concern over the ever increasing non-compliance rate, much emphasis has been placed by researchers to focus on this area of concern.

Generally, existing literature has focused not only on definitions of non-compliance, but also on the sub-categories within non-compliance, predominantly tax avoidance and tax evasion. However, recent issues such as creative compliance and over-compliance have also started to be in the spotlight for research. It is interesting to note here that although there is a significant number of studies on non-compliance, a majority of those do not place a significant weighting on definitions for just the concept of non-compliance, instead, existing literature have focused on the existence of sub-categories within non-compliance. This is perhaps because of the rather self-explanatory name of non-compliance, where it arises because of the failures by taxpayers to meet their tax obligations (Webley et al., 1991). Kirchler (2007, p. 21) believes non-compliance behaviour represents the "most inclusive conceptualization referring to failures to meet tax obligations, whether or not those failures are intentional." From this definition, it is evident that there are two main factors associated with the concept of tax non-compliance, namely: (A) the failure to meet tax obligations, and, (B) the failure may be intentional or unintentional. These two factors from Kirchler's (2007) study will act as the benchmark for other definitions listed in the table below.

Table 2: Definitions of 'Tax Non-Compliance'

Details of Study	Definition from study	Factors considered		Additional Notes (where applicable)
		Failure to meet tax obligations	*Intentional/ unintentional behaviour*	
Jackson and Milliron (1986)	There are many areas in the distinction between intentional and unintentional non-compliance.		√	Recognizes the many sub-categories that exist within the branch of non-compliance.
Robben et al. (1990)	The failure, intentional or unintentional, of taxpayer to meet their tax obligations. Whether deliberate or unintentional, non-compliance is relatively widespread.	√	√	A relatively accommodative definition for the possible behaviours within the branch of non-compliance.
Webley et al. (1991)	The intentional and unintentional failure of taxpayer to pay their taxes correctly.	√	√	
Jenkins and Forlemu (1993)	The failures to file returns, report income, calculate deductions properly, [and] pay [taxes] correctly and on time.	√		
Erard (1997)	Implies a failure, in the opinion of a tax examiner, to meet one's tax obligations.	√		The 'opinion' of the tax examiner may differ from the 'opinion' of a taxpayer.
Hasseldine and Li (1999)	Result from deliberate choices; it can also occur because of carelessness, omissions, and misinterpretations of requirements.		√	Takes into account both intentional and unintentional non-compliance.
Tan (1999)	Arises either due to a failure to file a tax return, misreporting taxable income, or misreporting allowable deductions from taxable income.	√		More of a description of non-compliance, as opposed to a definition.
Wenzel (2002)	[Non-compliance] includes intended as well as unintended failures to meet tax obligations (e.g. because of misinformation, misunderstanding, or calculation errors).	√	√	Takes into account both intentional and unintentional non-compliance.
Kasipillai et al. (2003)	The term encompasses both intentional evasion and unintentional non-compliance which is likely due to calculation errors and inadequate understanding of tax laws.		√	Takes into account both intentional and unintentional non-compliance.

Details of Study	Definition from study	Factors considered		Additional Notes (where applicable)
		Failure to meet tax obligations	*Intentional/ unintentional behaviour*	
Tan and Sawyer (2003)	[The] antithesis of compliance, it represents the failure by a taxpayer to meet all of their compliance obligations in a timely and accurate manner.	√		
Tedds (2006)	Income tax that is legally owed but is not reported or paid.	√		
Burton (2007b)	Occurs where there is a departure from "what the ATO [Australian Taxation Office] regards as the policy purposes of the Parliament's tax laws."	√		
Kirchler (2007)	The most inconclusive conceptualization referring to failures to meet tax obligations whether or not those failures are intentional. Does not necessarily imply violation of the law.	√	√	
U.S. Department of the Treasury (2009)	Non-compliance takes three forms: (1) Underreporting (not reporting one's full tax liability on a timely filed return); (2) Underpayment (not timely paying the full amount of tax reported on a timely-filed return); and (3) Non-filing (not filing required returns on time and not paying the full amount of tax that should have been shown on the required return).	√		More of a description of non-compliance, as opposed to a definition.
Kirchler and Wahl (2010)	Refers to the behavioural outcome of paying less tax than obligated. Underlying intentions of this behaviour could be minimizing tax payments by legal tax avoidance or by the violation of tax law.	√		
Prince Rasaq Kunle Quadri et al. (2010)	Failure to meet any of the obligations listed below may be considered to be non-compliant: -registration in the tax system -timely filing or lodgement of requisite taxation information -reporting of complete and accurate information; and payment of taxation obligations on time	√		This definition is similar to the definition that is currently being adopted by the IRD.

A number of non-compliance definitions from the table distinguish between 'intentional' and 'unintentional' non-compliance because of the growing importance to consider both of these types of taxpayer behaviours (Devos, 2008). However, it may also be argued that non-compliance is only a "neutral term" (Webley et al., 1991, p. 3) where the sub-categories within non-compliance are fairly dominant and it may be unnecessary for the concept of non-compliance itself to take into account those possible behaviours. Webley et al. (1991, p. 2) continue to state that the non-compliance concept "does not assume that an inaccurate tax return is unnecessarily the result of an intention to defraud the authorities and it recognizes that inaccuracies may result in the overpayment of taxes." The aspect of the 'overpayment' of taxes relates to the over-compliance sub-category of non-compliance, as will be explained in more detail later in this chapter.

Intentional and unintentional non-compliance does not appear to have been defined separately in existing literature, but there have been a number of studies that have described as to what contributes to intentional and unintentional non-compliance. Before outlining what can amount to intentional and unintentional non-compliance, Carroll (1992, p. 44) has provided a detailed example of what amounts to non-compliance in general by stating that non-compliance may arise when a "taxpayer is ignorant, lazy, careless, deliberately cheating, following occupational groups or workplaces, heeding incorrect advice from the IRS, [or by] making a symbolic protest against the tax system." By incorporating possible behaviours that may amount to non-compliance, this detailed list provide readers with a basic understanding of how complicated the category of non-compliance is, as the fault may have either originated from the Inland Revenue authorities (by giving out incorrect information) or the taxpayers themselves (by choosing not to comply with the tax regulations).

5.3.1 Intentional and unintentional non-compliance

The area of research on intentional non-compliance would have perhaps received the most amount of attention from researchers. In order to intentionally engage in non-compliant activities, some understanding of the tax system is believed to be a pre-requisite. Within intentional non-compliance, the two main sub-categories are tax avoidance and tax evasion. Although it is often difficult to distinguish between the two forms of non-compliance activity, they are "usually distinguished in terms of legality" (James and Alley, 2002, p. 31) Even within tax avoidance and tax evasion, there may be some other minor categories that exist within, but the focus of study is mainly focused on the sub-categories of tax avoidance and tax evasion within tax non-compliance, and so, those minor sub-categories would not be examined closely. Tax avoidance is viewed objectively[23] where the onus of proof is on the taxpayer as to whether they have been engaging in tax avoidance related activities. On the other hand, in order to establish tax evasion or related behaviours, it is necessary to assess the presence of 'knowledge' and 'intent' demonstrated by a taxpayer.

In contrast, unintentional non-compliance has not generally received as much attention in existing literature. The main cause of unintentional non-compliance has been found to be the result of the complexity of the tax systems in each country. Because of interpretation issues with the applicable rules and regulations, some taxpayers may unconsciously pay an amount that differs from their actual tax liability. For example, Hasseldine and Li (1999, p. 92) describe unintentional non-compliance may occur as a result of "carelessness, omissions and misinterpretations of requirements," or it may also be the result of "inadvertent memory lapses, calculation errors, or inadequate knowledge of tax laws" (Robben et al., 1990, p. 342).

[23] For more details on how tax avoidance is determined objectively, see *Ch'elle Properties (NZ) Limited v Commissioner of Inland Revenue* SC 46/2007 [2007] NZSC 73.

Despite a number of studies focusing on the causes of unintentional non-compliance, there remain areas of unexplored literature as to how the concept of unintentional non-compliance can be defined in a 'universal' manner. The absence of a definition has caused difficulties for the tax authorities to determine whether tax shortfalls unpaid by taxpayers are the cause of unintentional non-compliance, but some may argue that it is a challenge to determine the real cause of non-compliance by a taxpayer, that is, whether the cause of non-compliance was genuine or otherwise. In addition, James and Alley (2002) believe having no knowledge of a particular tax law/obligation does not equate to unintentional non-compliance. Therefore, it may be possible at this stage to only understand what causes and behaviours may be considered to be unintentional non-compliance due to the difficulties associated with attributing a 'universal' definition for the concept. Moving away from unintentional non-compliance, the following section discusses the main sub-categories within intentional non-compliance, with an emphasis on the concepts of tax avoidance, tax evasion and over-compliance.

5.3.2 Tax Avoidance

This sub-category within the branch of non-compliance has been researched extensively over the years. The term has generally been considered as a form of 'legal' method for taxpayers to reduce their tax liabilities. However, it is considered as a more aggressive approach when compared against other forms of legitimate tax minimization techniques (Webley et al., 1991 and Tooma, 2008), as it has even been labelled as a "cunning" method to avoid tax liabilities (Prebble, 2011, p. 10). The concept of tax avoidance is probably one of the most difficult concepts to define within the category of non-compliance due to the similarities it shares with tax evasion and other less common forms of non-compliance. However, Orow (1995a) believes that the issues and problems associated with tax avoidance are because of the unavoidable and inescapable payment of tax liabilities. It is interesting to

note that unlike the concept of tax evasion, tax avoidance was not a term that was applied in government documents until the early 19th Century (Hughes, 2009).

Both tax avoidance and tax evasion have the common ultimate goal to escape the payment of true tax obligations faced by a taxpayer. However, the distinction between the two can usually be recognized between the approaches taken by a taxpayer when carrying out an activity (McBarnet, 1992). Tax avoidance involves the legal use of methods to "neutralize its impacts" (McBarnet, 1992, p. 341), where it seeks to reduce a taxpayer's payment of taxes. On the other hand, tax evasion involves the application of methods that "simply ignore or break the law" (McBarnet, 1992, p. 341).

Wenzel's (2002, p. 360) definition of tax avoidance is described as "the deliberate acts of reducing one's taxes by legal means." The three characteristics that will be used as benchmarks for the definitions outlined in the table below are: (A) a legal behaviour, (B) a deliberate act that involves planning and/or an arrangement; and (C) to reduce tax liabilities.

Table 3: Definitions of 'Tax Avoidance'[24]

Details of Study	**Definition from study**	**Factors considered**			**Additional Notes (where applicable)**
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Richardson (1967)	Reducing the burden of tax by legal means.	√		√	
Van Hoorn Jr. (1974)	It is considered as referring to an attitude of unethical and, indeed, unlawful behaviour, although it is actually a neutral term.				

[24] Some of the tax avoidance definitions from Table 3 are from the United States of America (USA) and in their tax law context, tax avoidance is regarded as acceptable behaviour and within the law. It is regarded in the USA as a synonymous for tax mitigation or tax minimization.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Clyne (1979)	Planning your commercial life in such a way as to become liable to pay no tax, or to pay as little tax as possible.		√	√	
Gassner (1983)	Refers to taxpayers' freedom to present their income in such a form that they pay the minimum in tax by respecting the "letter of the law".		√	√	One of the few definitions to look at the issue from the 'letter' and 'spirit' perspective.
Groenewegen (1985)	Tax minimization by *legally* taking advantage of the tax reduction potential of certain sections of the tax act. Avoidance therefore involves the taxpayer in legal though artificial action which combines tax saving with a (more roundabout) achievement of the transaction's principal objective.	√	√	√	A relatively accommodative definition for tax compliance as it considers both the objective and goal for minimizing one's tax obligations.
Committee on Fiscal Affairs (1987)	Tax planning or abstention from consumption.		√		
Pyle (1989)	[The] entirely legitimate use of tax loopholes in order to minimize one's (income) tax burden. [Taxpayers may be] behaving quite legitimately, although in some cases perhaps cynically, in order to reduce one's tax payments.	√	√	√	
Alm et al. (1990)	Any legal activity that lowers taxes.	√		√	The words '*any* legal' may not necessarily limit to acts of tax avoidance if other sub-categories of non-compliance are taken into consideration.
Webley et al. (1991)	Involves every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred… It presupposes the existence of alternatives, one of which would result in less tax than the other.	√	√	√	The words '*every* attempt' may be too broad for tax avoidance as some attempts to reduce tax liabilities may be the result of legitimate tax planning.
McBarnet (1992)	Accepted as lawful. The use of legal techniques to avoid tax.	√	√	√	

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Orow (1995a)	The unacceptable or illegitimate minimisation of tax liabilities which do not break the law. [That is,] an illegitimate means of obtaining a tax advantage.	√		√	
Ohms (1996b)	Involves a transaction entered into for the purpose of obtaining a tax benefit.		√	√	
Sawyer (1996)	Disallowing certain expenditure as a deduction or deeming certain revenue flows to be taxable income, thereby creating a further tax liability.		√	√	
Armstrong and Robinson (1998)	Constitutes legal methods by which a taxpayer can reduce their tax bill.	√	√	√	
Hopper et al. (1998)	The reduction of tax liability based on a literal interpretation of tax legislation, but outside the intention/purpose of the tax legislation and having the principle effect of altering the incidence of income tax.			√	Considers the 'letter' and 'spirit' of law even though the objective is to reduce one's tax liabilities.
Walkey and Purchas (1998)	Taxpayers legally structure transactions in order to minimize their taxable income, and therefore their taxation liability.	√	√	√	May be perceived as more of a definition for tax planning, rather than tax avoidance.
Franzoni (2000)	Individuals reduce their own tax in a way that may be unintended by tax legislators but is permissible by law. Avoidance is typically accomplished by structuring transactions so as to minimize tax liability.		√	√	
James and Alley (2002)	Legal measures to reduce tax liability.	√		√	Too broad to really grasp the concept's true nature (that is, does not quite capture what tax avoidance may involve).
Wenzel (2002)	Deliberate acts of reducing one's taxes by legal means.	√	√	√	

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Braithwaite (2003a)	A number of cautious minimizing strategies, number of aggressive minimizing strategies, and effort to minimize [tax liabilities].		√	√	The use of the phrase 'aggressive minimizing strategies' may be too harsh for tax avoidance as it may be better suited for other more serious forms of non-compliance (for example: a taxpayer taking an abusive tax position).
Kasipillai et al. (2003)	Is legal and denotes the taxpayers' ingenuity to arrange his affairs in a proper manner so as to reduce the incidence of tax.	√	√	√	
Kirchler et al. (2003)	An attempt to reduce tax payments by legal means, for instance, by exploiting tax loopholes.	√	√	√	
Freedman (2004)	All arrangements to reduce eliminate or defer tax liabilities that are not illegal.	√	√	√	This definition is too broad for the concept of tax avoidance.
Sandmo (2004)	Within the legal framework of the tax law. It consists in exploiting loopholes in the tax law in order to reduce one's tax liability; converting labour income into capital income that is taxed at a lower rate provides one class of examples of tax avoidance.	√	√	√	
Tedds (2006)	Legal actions taken to reduce tax liability.	√	√	√	
Hofmann et al. (2008)	The legal reduction of income and/or the legal increase of expenditures by a creative design of the tax statement (It is legal and moral).	√	√	√	Takes into account that avoidance is not unique to only the minimization of income, but also expenditures.
McLaren (2008)	An act within the law.	√	√		This definition is considered to be too generic, and does not consider the essence of tax avoidance behaviours.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Simser (2008)	[Tax avoidance] is perfectly acceptable.	√			It is questionable as to whether it refers to 'acceptable' within the law or 'acceptable' in general when compared against other tax minimization techniques.
Tooma (2008)	Involves the legal exploitation of the letter of the law to one's own advantage, without regard to the broader purpose of the tax laws.	√		√	
Griffiths (2009)	Tax avoidance is imprecise, open-textured, incoherent and indefinable.				Describes the tax avoidance problem rather than providing a definition for the concept.
Hughes (2009)	The use of schemes which do not breach the letter of the law but do breach its underlying intention or spirit. Tax avoidance is [a] legal activity, as opposed to tax evasion.	√	√		Notes the importance of distinguishing between the 'letter' and the 'spirit' of the law.
Trombitas (2009)	As a general proposition, tax avoidance arises in situations where the letter of the law says (or permits) that tax is not payable or that tax savings are allowed, but the policy of the tax law (based on the legislative scheme) has it that tax should be paid or not reduced. In other words, tax avoidance always arises in situations when the letter of the law is met but the spirit (or policy) of the law is breached. Tax avoidance is undesirable.	√		√	Notes the importance of distinguishing between the 'letter' and the 'spirit' of the law.
Balestrino (2010)	It is tax dodging, where it is a riskless but costly activity.		√		A general definition as most tax minimization activities are considered to be "costly".

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Kirchler and Wahl (2010)	[Tax avoidance] is legal. Taxes are intentionally reduced by legal means trough taking advantage of loopholes in the tax law.	√	√	√	
Lim (2010)	Tax savings that arises from both the general tax reduction methods and tax shelters that are occasionally of questionable legality to minimize tax liability. In other words, the tax avoidance measure conceptually captures the cumulative number of transactions to minimize tax liabilities.		√	√	
Murphy (2010)	Seeking to minimize a tax bill without deliberate deception (which would be tax evasion) but contrary to the spirit of the law. It therefore involves the exploitation of loopholes and gaps in tax and other legislation in ways not anticipated by the law.		√	√	As there is a fine line between acceptable tax minimization and tax avoidance, it is questionable as to whether this definition is too lenient for tax avoidance as it may involve deliberate actions from the taxpayers' behalf.
Sikka and Willmott (2010)	Considered to be lawful.	√			This definition may be considered as a more appropriate definition if it were to define *all* legal ways to reduce one's tax burden. That is, this definition is again too simplistic
Elliffe (2011)	Involves a taxpayer entering into an arrangement that alters the incidence of tax. The transaction actually entered into by them generates the income or expenditure that is returned in the tax return.				
Keating and Keating (2011)	Taxpayers who arrange their affairs to reduce the potential tax liability		√	√	
Perez (2011a)	Minimizing your taxes through legal, but aggressive, tax planning strategies. The opposite of tax avoidance is tax evasion.	√	√	√	

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Legal behaviour	*Deliberate act*	*Reduce tax liabilities*	
Prebble (2011)	Tax avoidance falls between tax evasion and mitigation on the scale of tax minimising behaviour…Unlike evasion, avoidance is not criminal, and is often said to be legal. Avoidance exploits the tax law to use it in ways unintended by Parliament by following its black letter requirements but not its spirit.	√	√		Distinguishes between complying with the 'letter' of the law and complying with the 'spirit' of the law.
University of Auckland (2011)	Tax avoidance is not a criminal offence. It does not turn on misrepresentations being made to Inland Revenue; on the contrary, taxpayers accused of tax avoidance have commonly disclosed to Inland Revenue far more information about their affairs than they are required to by law.	√			Questionable as to whether 'additional' information has really been disclosed to Inland Revenue as tax avoidance is usually related to omissions where taxpayers have not disclosed sufficient information...

It is interesting to note that the definitions brought up by Hughes (2009), Murphy (2010) and Perez (2011a) all compared tax avoidance against tax evasion, where they believe the former to be the 'opposite' of the latter in terms of legality. This may be considered as a general understanding when looking at the definitions from the tables but it is by no means adequate as it is important to also consider other legal forms of tax minimization techniques where they may all be considered as 'opposites' of tax evasion.

The difficulties involved in defining the concept of tax avoidance have led to some studies to 'extract' other sub-categories within the branch of tax avoidance. For example, Van Hoorn Jr. (1974) states that there are different variations as to how the concept of tax avoidance is recognized in each country, for example, the term, 'abusive tax position' is unique to the New Zealand context where it is understood as a more serious form of tax

avoidance.[25] Griffiths (2009, p. 165) states that abusive tax position is like "abusive avoidance where it attracts penalties."

Abusive tax position is deemed to have occurred "if a taxpayer enters an arrangement with the dominant or substantive intention of producing a tax advantage and cannot show that he has a reasonably arguable position…" (Sawyer, 1996, p. 484). The boundary between acceptable tax planning and tax avoidance (unacceptable, but legal) is not always distinguishable, but the balance between the economic substance and the complexity of an arrangement is perceived as a key identifier as to whether a particular behaviour is acceptable or otherwise (Sawyer, 1996). Both tax avoidance and abusive tax position leads to the result of less tax payable, and so it is reinforced in the Interpretation Statement 0061 (IS0061) issued by the Inland Revenue Department (IRD) that the avoidance of tax is not limited to only the concept of tax avoidance. Unlike situations where a taxpayer takes an abusive tax position, tax avoidance does not require a dominant purpose of avoiding taxes as tax avoidance is viewed objectively. As a result of these complications, nearly all studies have taken a slightly different approach when defining the concepts associated with the tax avoidance issue.

A number of existing studies have found that the sole purpose of engaging in tax avoidance arrangement by taxpayers is to reduce the amount of taxes payable (paid) through legal means (Richardson, 1967; Clyne, 1979; Hawes, 1996; Armstrong and Robinson, 1998; and Dyreng et al., 2007). Taking advantage of the grey areas of tax law can arise from a number of possible actions, including, "income splitting, postponement of taxes, and tax arbitrage across income that faces different tax treatments" (Alm, 1999, p. 741). These factors then contribute to how the concept of tax avoidance has been defined over the years.

[25] For more information on abusive tax position, see the IRD's (2005) Interpretation Statement on Abusive Tax Position.

However, the scope of tax avoidance should be more widespread that what has been proposed by existing studies as some of the tax avoidance approaches identified by Alm (1999) may be perfectly legal and completely acceptable in some countries. In addition, Dyreng et al. (2007, p. 62) states there are "numerous provisions in the tax code that allow or encourage firms to reduce their taxes." This is supported by Tooma's (2008, p. 16) study that all "taxpayers should be allowed to arrange their affairs so as to pay the least tax possible." Therefore, a comprehensive definition for the concept of tax avoidance should consider the *degree* or *extent* in which arrangements have been carried out by taxpayers. In addition, it is important to bear in mind that the definition of tax avoidance may differ between each country due to the approach taken as to what could be considered as standard acceptable behaviour. [26]

In order to go beyond the general understanding that tax avoidance leads to less taxes payable legally, Richardson (1967, p. 8) proposes that there are two other distinct qualifications associated with the behaviour of tax avoidance. The first is that "avoidance must be an objective of a transaction," and second, the taxpayer must be doing more than just "deliberately seeking those tax benefits" (Richardson, 1967, p. 8). However, this approach may be considered to be more appropriate for understanding the concept of abusive tax position.

Another approach taken is evident from Bracewell-Milnes' (1980) study where the issue is separated between 'objective' and 'subjective' tax avoidance. Within the study, Bracewell-Milnes (1980, p. 13) describes 'subjective' tax avoidance as the "narrower concept" between the two, where it accommodates behaviours that are "both intentional and factitious in the sense that the taxpayer desires to retain the economic substance of a transaction while

[26] For example, the United States' tax authorities accept that taxpayers may be involved in acts of tax avoidance (and thus the distinction between 'acceptable' tax avoidance and 'unacceptable' tax evasion), but in New Zealand's context, both tax avoidance and tax evasion are unacceptable.

mitigating ten tax consequences by an adjustment of its form" (Bracewell-Milnes, 1980, p. 13). On the other hand, objective tax avoidance arises when there is a "tax reduction of any kind and for and motive" (Bracewell-Milnes, 1980, p. 13), where it may involve actions from contemplating schemes for deliberate avoidance of taxes to unplanned tax reductions.

Despite the general consensus established across studies that tax avoidance is a form of legal behaviour to reduce one's tax obligations, studies have yet to develop methods to divide between acceptable tax planning, abusive tax position and tax avoidance behaviours. This then has an effect on how tax avoidance can be defined in a 'universal' manner. This is predominantly the result of the difficulties associated with the ability to clearly distinguish between the concepts because of the "grey area between tax avoidance and tax minimization [and possibly other behaviours associated with tax avoidance]" (Hawes, 1996, p. 15). In addition, as some researchers have used different terms when studying the tax avoidance concept, this then complicates the issue as they are bringing their own interpretations of the concept into their individual studies.

Picciotto (2007) raises an interesting approach for viewing the tax avoidance problem where tax avoidance behaviours can be viewed as a 'game'.[27] This 'game' is "one in which the players seek to interpret the rules to their advantage, but in a formalist and technicist manner, that is, by referring only to the apparent internal logic of the rule-system, without feeling any need to justify their interpretation of a rule by reference to broader considerations" (Picciotto, 2007, p. 11). However, the difficulties associated with distinguishing between legal and illegal methods of tax minimization is still blurred, as it is up to the *extent* in which a taxpayer minimizes their tax obligations, because the line between the two will always be hard to determine. Therefore, although it appears that some issues surrounding the tax avoidance problem has been clarified, there remains a high level of confusion as to what tax

[27] See Braithwaite (2003a) and Picciotto (2007) on how they have compared tax avoidance to a 'game'.

avoidance entails and when particular tax avoidance behaviour crosses the line to illegal tax evasion behaviour.

Nevertheless, the cause of the inconsistencies from the definitions established over the years is mainly the result of the differences in perspectives from the taxpayer and the Inland Revenue (or equivalent) organizations. Some behaviours, when viewed from the taxpayers perspective, may be perfectly acceptable as it aligns with the 'black' letter of the law, but this may lead to a contravention of certain sections from the Inland Revenue's perspective, and undoubtedly, vice versa. As a result, a 'universal' definition for tax avoidance would be difficult to articulate in practice because of the differences in the understanding of the term between taxpayers and the Inland Revenue organizations. However, the legality aspect between tax avoidance and tax evasion acts as an important distinction between the two concepts as it sets the boundary for what is acceptable under the tax avoidance umbrella (Orow, 1995b). The following section considers some of the sub-categories associated with the concept of tax avoidance, where a brief description on each of the concepts have been intended to enhance our overall understanding on the broad concept of tax avoidance.

5.3.2.1 Tax mitigation

The concept of tax mitigation has also been referred to in some studies and especially in the *Challenge* (1986)[28] and *Ben Nevis* (2008) cases. Tax mitigation has been described as a form of legal and acceptable method to reduce one's tax liabilities (Sawyer, 1996; Evans, 2007; Hughes, 2009; and Baker, 2011). This concept can be understood to be a term that exists between the domains of unacceptable tax planning and tax avoidance (Sawyer, 1996 and Hughes, 2009), or it may be considered to be a complementary term for legitimate tax minimization (Baker, 2011). Prebble (2011, p. 8) explains tax mitigation as behaviours that

[28] *Commissioner of Inland Revenue v Challenge Corporation Limited* [1986] 8 NZTC 5,219.

follow "both the letter and the spirit of the law, whereas, avoidance follows the former but not the latter." However, this is not a term that is commonly referred to in literature as its characteristic with tax avoidance is too alike and some courts have found it unhelpful to separate the two concepts (Evans, 2007; and *Ben Nevis* Supreme Court, 2008). This can be supported by Lord Nolan's judgement in the *Willoughby*'s (1997)[29] case where he explains:

> "*The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option*" (paragraph [73]).

5.3.2.2 Creative compliance

In Chapter 2, the essential but often unexplored notion of creative compliance was described briefly where it is considered to be under the branch of non-compliance. After further research, only a very limited number of studies (see Shah, 1996; McBarnet 2003 and 2007) have a tendency to separately address this concept from tax avoidance. McBarnet and Whelan (1991) made it clear within their particular study that the concept of creative compliance is not unique to only accounting and law domains, but this concept may also be meaningful and useful in other areas of practice and research.

Due to the 'improved' techniques involved in an attempt to reduce one's tax liabilities legally, the concept of creative compliance is in no doubt to be more accepted and applicable in practice now, compared to a decade or so ago. McBarnet (2007, p. 1) defines creative

[29] *Commissioner of Inland Revenue v Willoughby* [1997] 4 ALL ER 65.

compliance as "the use of technical legal work to manage the legal packaging, structuring and definition of practices and transactions, such that they can claim to fall on the right side of the boundary between lawfulness and illegality." More plainly, it is the practice of "using the letter of the law to defeat its spirit, and to do so with impunity" (McBarnet, 2007, p. 1). It is important to acknowledge that creative compliance behaviours are not behaviours that have violated the law, but rather, it is associated with taxpayers taking advantage of the grey areas of the legislation. For example, McBarnet and Whelan (1991, p. 850) perceive creative compliance to be a "prerequisite to a successful 'off balance sheet financing' transaction (OBSF)." This move is to allow the "funding or refinancing of a company's operations in such a way that, under legal requirements and existing accounting conventions, some or all of the finance may not be shown on its balance sheet" (McBarnet and Whelan, 1991, p. 850). The other study by McBarnet (2003) describes the core of creative compliance as representing the way that taxpayers manage their tax obligations in accordance with the 'letter' of the law, while undermining the other important, but often ignored, 'spirit' of the law.

Despite preliminary studies concerned with creative compliance, it is still too early to reach a conclusion as to whether creative compliance is a more appropriate fit under the main category of tax compliance than non-compliance due to the absence of further studies to be conducted by different researchers. However, what can be agreed on the concept of creative compliance is the 'active' involvement of taxpayers in arrangements to reduce their true tax liabilities in a legal manner. This is supported by an earlier study by McBarnet and Whelan (1991, p. 848) where they explained the process of creative compliance as "…the active response of those subject to the law, not just in political lobbying over legislation but in post hoc manipulation of the law to turn it- no matter what the intentions of the legislators or enforcers- to the service of their own interests and to avoid unwanted control."

As a result, the categorization of creative compliance should be dependent upon the extent of the activities involved to reduce the 'true' tax liabilities of a taxpayer in order to determine whether it is a form of tax compliance or non-compliance behaviour. If it is to be recognized as a form of non-compliance behaviour, then the issue of how it is placed on a spectrum ranging from legal tax planning to illegal tax evasion needs to be determined. This is because of the result of an inconsistency between Anderson's (1993) study where it deems creative compliance to be more serious than 'general' tax avoidance and Picciotto's (2007) study where it recognizes creative compliance to be a sub-branch that exists within the branch of tax avoidance. Therefore, although the concept of creative compliance is still missing a 'universal' definition, some solid foundation has been set on the essence of what the concept entails, in particular, it has been agreed from various studies that it is a legal behaviour, and this is achieved through the utilization of the "legal forms which hide the reality of relationships, economic statutes and risk [to minimize one's true tax liabilities]" (McBarnet and Whelan, 1991, p. 854).

5.3.2.3 Tax flight

The study by Kirchler et al. (2003) extracted a term that stands in between tax avoidance and tax evasion, called tax flight. It is not a term that is frequently discussed in existing literature, but it is without a doubt, one of the many grey areas that cannot (or has not) been discussed independently from tax avoidance and tax evasion (Slemrod and Yitzhaki, 2003). Tax flight refers to the "relocation of businesses, only in order to save taxes, for instance by making use of offshore tax havens" (Kirchler et al., 2003, p. 3). The term has also been perceived as the product of either tax avoidance or tax evasion behaviour where money has been transferred offshore to reduce taxes payable (Gibson, 2010). But according to Kirchler et al. (2003), tax flight is to be placed between tax avoidance and tax evasion because of the similar effects it shares with the two. Not only is tax flight considered morally

wrong, but it also lacks the economic reality in what is usually evident in a tax avoidance arrangement; however, it is not a criminal offence like tax evasion (Kirchler et al., 2003).

Another difference between tax avoidance and tax flight is the belief that tax flight is "associated with an intention to save taxes, with an impression that taxes are substantially lower abroad as well as with double tax agreement and costs of relocation" (Kirchler et al., 2003, p. 9), where as tax avoidance is a legal way to save taxes, but with "cleverness and a good idea as well as with costs" (Kirchler et al., 2003, p. 9). That is, tax savings are considered as the central motive for tax flight and tax avoidance, whereas, tax evasion is associated with "thoughts of illegality, risk or by criminal prosecution" (Kirchler et al., 2003, p. 9). In general, tax flight is considered to be fairer than tax avoidance and tax evasion, but still perceived as an immoral behaviour. Tax flight is believed to impose negative impacts to the government by way of reduced tax revenues (Kapoor, 2011), but this is outside the scope of this study. Further analysis is required to determine whether tax flight should be considered as a product of tax avoidance or evasion, or whether it should be placed in between the two terms. But in the mean time, one may not see the importance of further defining immaterial terms within tax avoidance and tax evasion as it does not disentangle the complexities associated with the avoidance/evasion problem, but rather, it complicates the problem in an unhelpful manner.

5.3.3 Tax Evasion

Tax evasion represents the utmost serious form of tax non-compliance. Unlike tax avoidance, tax evasion has always been associated with the illegal methods taken by taxpayers to reduce their tax liabilities intentionally, or with their pre-requisite knowledge. Although an illegal approach to reduce tax payment, when viewed from an economic perspective, tax evasion is on the same scale of negative influence as tax avoidance because

of its fiscal result experienced by the government (Orow, 1995a). In order to establish the presence of tax evasion, it is important to distinguish the level of *knowledge* and/or *intent* demonstrated by the taxpayer around the situation. Similar to other forms of non-compliance, tax evasion has also been at the core of research for many studies over the years due to the seriousness of the problem and the difficulties involved in classifying particular taxpayer behaviours as a form of tax non-compliance.

Clotfelter (1983, p. 364) believes "the line separating 'evasion' from simple mistakes in judgement or calculation is usually a difficult one to draw." As a result, Kolm (1973) and Porcano (1987) both realize that the tax evasion problem cannot be fixed and we should accept the fact that "some degree of tax evasion [should be] expected and tolerated" (Porcano, 1987, p. 48). This is especially true as the strategies and attempts to achieve a higher compliance rate are both costly and to an extent, impossible for tax authorities.

Although tax evasion is regarded as a form of illegal behaviour when compared against other forms of non-compliance, but when compared against other forms of crime, tax evasion is not regarded as morally wrong or considered as a serious form of crime (Song and Yarbrough, 1978; Kasipillai et al, 2003; Gupta, 2006; and Gupta, 2007), especially if the monetary amount at issue is insignificant. Song and Yarbrough (1978) conducted a study where it found that tax evasion is considered by some taxpayers as only a slightly more serious crime than stealing a bicycle. This is perhaps due to the belief that tax evasion is 'victimless crime' where tax evaders do not physically experience the impact of their non-compliant behaviours.[30]

[30] Tax evasion was defined in *R v Hargraves and Stoten* [2010] QSC 188 as:

> "*Not a game, or a victimless crime. It is a form of corruption and is, therefore, insidious. In the fact of brazen tax evasion, honest citizens begin to doubt their own values and are tempted to do what they see others do with apparent impunity. At the very least, they are left with a legitimate sense of grievance, which is itself divisive. Tax evasion is not simply a matter of failing to pay one's debt to government. It is theft, and tax evaders are thieves* (paragraph [41])."

Tax evasion is defined by Wenzel (2002, p. 630) as taxpayers engaging in arrangements involving "deliberate criminal non-fulfilment of tax liabilities," and using this definition as a benchmark, three factors can be extracted, namely: (A) An illegal activity, (B) the involvement of deliberate acts, and (C) less payment of taxes due. The following table incorporates a selection of tax evasion definitions that has been applied in existing literature over the years.

Table 4: Definitions of 'Tax Evasion'

Details of Study	**Definition from study**	**Factors considered**			**Additional Notes (where applicable)**
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Radcliffe Commission (1955)	All those activities which are responsible for a person not paying the tax that the existing law charges upon his income. Ex hypothesis he is in the wrong, though his wrong doing ranges from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time.		√	√	This definition has also been cited by Tooma (2008) and Orow (1995a and 1995b).
Carter Commission (1966)	Adopted the *Radcliffe Commission*'s definition and added that tax evasion is illegal; [and] avoidance is not. *Radcliffe Commission*'s definition of tax evasion is - All those activities which are responsible for a person not paying the tax that the existing law charges upon his income. Ex hypothesis he is in the wrong, though his wrong doing ranges from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time.	√		√	A thorough definition for tax evasion from the 1960s, and unfortunately, recent studies are unable to provide a better definition for the concept.
Richardson (1967)	Reducing the burden of tax by illegal means.	√		√	

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Van Hoorn Jr. (1974)	An action by which a taxpayer tries to escape his legal obligations by fraudulent means.	√		√	
Clyne (1979)	Means fraud, dishonesty, false returns, double book entries, forgery and dishonest and/or illegal methods.	√		√	
Bracewell-Milnes (1980)	Tax fraud.				One of the few studies that views tax evasion in the same manner as tax fraud.
Lewis (1982)	Between evasion by commission and evasion by omission and that between intentional and unintentional evasion.				
Gassner (1983)	Begins when the "letter of the law" is not accepted.				An interesting (and unique) approach to look at the concept of tax evasion, as the 'letter' of the law may have been long ignored with other less serious forms of non-compliance.
Groenewegen (1985)	An *illegal* act involving fraud. Evasion is therefore essentially not paying a legal assessable tax liability. It therefore assumes a fraudulent intention on the part of the taxpayer.	√	√	√	
Porcano (1988)	[Taxpayers who] do not pay their fair share; they reduce their tax payments through various schemes. Some degree of evasion is expected and tolerated.			√	Recognizes that even with a zero *tolerance* rate for tax evasion, the *outcome* may not necessarily be as expected

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Wallschutzky (1988)	Paying less tax than would otherwise be the case and it is achieved by means which are outside the law. Only one form of non-compliance, albeit the most serious.	√		√	
Pyle (1989)	Hiding part of one's income from the income tax authority. [Tax evasion] is an illegal activity, although it should be emphasized that the activities which generated the income need not be illegal.	√			Raises the importance to distinguish between the *nature* of the income generated and the *treatment* of that particular income amount.
Alm et al. (1990)	The reduction in tax liability by illegal means.	√		√	
Robben et al. (1990)	Deliberate acts of non- compliance which result in the payment of less tax than is actually owed.		√	√	
Webley et al. (1991)	Illegal. It can involve acts of commission or omission	√			
McBarnet (1992)	Illegal. [Tax evasion is] subject to civil or criminal penalties.	√			
Hawes (1996)	Against the law. [Tax evasion] is about telling lies and cheating. Tax evasion is about not declaring income, or lying about your expenses. Tax evasion is about deliberately understating your taxable income or over claiming your deductions.	√	√	√	Considers the possible behaviours from the taxpayers' part. These descriptions are a good example for understanding tax evasion.
Ohms (1996a)	An offence requiring criminal intent (mens rea) and proof beyond reasonable doubt. Within this process some taxpayers choose to simply to omit income or falsify deductions.	√	√		

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Ohms (1996b)	Involves an intention to avoid payment of tax where there is actual knowledge of liability or the circumstances should indicate it.		√		
Prebble (1996a)	An unadorned failure to report assessable income.			√	
Prebble (1996b)	For example, someone may be guilty of tax evasion where: - She labels a component of a transaction that she undertakes with a name that would have the effect of minimizing tax (for example, "gift" rather than "payment"); - The label is wrong; - She fails to disclose the transaction to the Commissioner of Inland Revenue in detail sufficient for the Commissioner to decide whether the label is correct; - She under-declares her income because she returns it on the basis that the label is right, although it is in fact wrong.		√	√	This is more of an example for tax evasion, rather than an explicit definition for the concept.
Sawyer (1996)	An illegal underlying activity. [It is] the most severe form of non-compliance and represents a wilful or knowing breach of a tax obligation.	√	√		
Armstrong and Robinson (1998)	Comprises illegal methods of tax dodging.	√		(√)	Tax dodging is understood within this study as taxpayers not meeting all their true tax liabilities.
Hopper et al. (1998)	The deliberate non-compliance with tax legislation resulting in the non-payment of tax liabilities which have been incurred. Tax evasion implies the use of fraud or concealment to escape the payment of tax, or to obtain a reduction or repayment of tax that is not legally due.		√	√	

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Walkey and Purchas (1998)	The deliberate and illegal action taken by taxpayer to avoid paying tax.	√	√	√	
Alm (1999)	Consists of illegal and intentional actions taken by individuals to reduce their legally due tax obligations.	√	√	√	
Sandford (1999)	The failure, by an individual or organization, to pay tax legally due, or alternatively the claim of a refund to which they are not legally entitled. Tax evasion embraces both deliberate acts and unintentional evasion arising from ignorance of the law or forgetfulness. Tax evasion ranges from minor omissions to major fraud.	√	(√)	√	Tax evasion may arise from both intentional and unintentional acts.
Franzoni (2000)	[Occurs] when individuals deliberately fail to comply with their tax obligations. [Tax evasion] is unlawful, and hence punishable (at least in theory).	√	√	√	
McIntosh and Veal (2001)	Where taxpayers deliberately understate their income or claim deductions they are not entitled to.		√	√	
James and Alley (2002)	Illegal measures to reduce tax liability.	√		√	
Wenzel (2002)	Deliberate criminal non-fulfilment of tax liabilities.	√	√		
Braithwaite (2003a)	An option [for taxpayers] who dislike tax and have located themselves outside the reach of the law, at least psychologically.	√	√		Tax evasion may not simply arise as a result of the dislike for the law, therefore, does not capture the full core of tax evasion.
Kasipillai et al. (2003)	Illegal. The deliberate acts of non-compliance resulting in payment of lower taxes than are actually owed.	√	√	√	A fairly comprehensive, but simple, definition for tax evasion.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Kirchler et al. (2003)	An illegal reduction of tax payments, for instance by underreporting income or by stating higher deduction-rates.	√		√	
Murphy (2003)	A strategy [that may involve a] non-compliant or fraudulent activity.				
Sandmo (2004)	A violation of the law. When the taxpayer refrains from reporting income from labour or capital which is in principle taxable, he engages in an illegal activity that makes him liable to administrative or legal action from the authorities. In evading taxes, he worries about the possibility of his actions being detected.	√		√	
Murphy (2005)	Strategies that may involve non-compliant or fraudulent activity.				
South African Revenue Service (2005)	In an income tax context, it typically involves the non-payment of a tax that would properly be chargeable if the taxpayer made a full and timely disclosure of income and allowable deductions. (Common examples of tax evasion include a 'deliberate failure' to report a full amount.)		√	√	
Cummings et al. (2006)	Is an illegal activity.	√			
Gupta (2006)	Occurs where a taxpayer has made a deliberate or intentional attempt to cheat Inland Revenue.		√		This definition may be too broad as deliberate and intentional attempts may not necessarily refer to acts of evasion.
IRD (2006)	Occurs when a taxpayer deliberately breaches a tax obligation. Evasion requires intentional behaviour or subjective recklessness; negligence and carelessness are insufficient.		√		Confirms the idea that tax evasion requires intent and/or knowledge from the taxpayers' part.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Tedds (2006)	Income tax that is legally owed but not reported or paid.			√	
Gupta (2007)	Occurs when a taxpayer has made a deliberate or intentional attempt to cheat Inland Revenue. Tax evasion and defrauding the revenue are for most purposes synonymous; definitions of one may serve as definitions of the other.	√	√		Suggests that tax fraud may be a synonymous term for tax evasion.
Hofmann et al. (2008)	A deliberate illegal act to reduce tax burden (It is an illegal behaviour and immoral).	√	√	√	
McLaren (2008)	An act outside the law.	√			
Simser (2008)	[Tax evasion] is unacceptable.				It is a statement on tax evasion, rather than a definition.
Tooma (2008)	The 'unlawful escaping' of tax liability. Tax evasion involves taxpayers to deliberately misrepresenting or concealing the true state of their affairs to tax authorities to reduce their tax liability. That is, evasion requires deceit on the part of the taxpayer.	√	√	√	
Coleman (2009)	A contract to evade tax currently due is illegal and void. Evasion of tax is an offence – the offence requires knowing action with intent to evade.	√	√		
Hughes (2009)	Illegal activity. Taken to denote criminal offences, such as the deliberate omission or understatement of income undertaken with the intention of not paying tax where such payments are required by law.	√	√	√	

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Balestrino (2010)	Risky because of the possibility of pecuniary sanctions if discovered.				Does not explicitly imply that tax evasion is illegal, but the definition implies that if discovered, there will be consequences.
Kirchler and Wahl (2010)	Tax evasion… is illegal, as taxpayers break the law deliberately through understating income (e.g. failing to report assets) and/or through exaggerating deductions (e.g. falsely reporting personal expenses as business expenses.	√	√	√	A fairly comprehensive, but simple, definition for tax evasion.
Murphy (2010)	The illegal non-payment or under-payment of taxes, usually resulting from the making of a false declaration or no declaration at all of taxes due to the relevant tax authorities, resulting in legal penalties (which may be civil or criminal) if the perpetrator of tax evasion is caught.	√		√	
Sikka and Willmott (2010)	Involves practices that contravene the law.	√			
Xynas (2010)	Always been regarded as unacceptable at law. Tax evasion can occur where taxpayers employ fraudulent methods to evade the payment of taxes.			√	
Elliffe (2011)	Failure by a taxpayer to discharge a known tax obligation.		√		May also be other forms of non-compliance, thus, this definition is too broad for tax evasion.

Details of Study	Definition from study	Factors considered			Additional Notes (where applicable)
		Illegal activity	*A deliberate act*	*Less payment of taxes due*	
Keating and Keating (2011)	Taxpayers who deliberately cheat the tax system.		√		May also be other forms of non-compliance, thus, this definition is too broad for tax evasion.
Perez (2011b)	Minimizing or eliminating your taxes by using illegal tax strategies. Opposite of tax avoidance. Illegal strategies might include outright lying or cheating on a tax return, or might involve using your or more abusive tax schemes.	√		√	
Prebble (2011)	Tax evasion is illegal and often criminal…There are different types of evasion, but typical examples involve the understating of income.	√		√	A rather common approach for understanding the concept of tax evasion.
University of Auckland (2011)	Tax evasion is tantamount to fraud. It is a criminal offence.	√			Implies that tax evasion and fraud may be considered as complementary terms.

It is evident from the definitions that tax evasion is regarded as a form of illegal behaviour, but unlike tax avoidance, the concept of tax evasion is "not specifically defined in the income tax legislation" (McIntosh and Veal, 2001, p. 11). As with the definitions for the concepts of tax compliance and non-compliance, the length and the comprehensiveness of the definitions for tax evasion also differ.

With the growing number of studies conducted around tax evasion, one should consider that an adequate definition for the concept should cover more information than just the legality aspect. It is also extremely important to examine whether such behaviours are

intentional or otherwise, and whether the taxpayer had the knowledge that they were acting against the relevant legislation. The definitions that go beyond considering the *legality* of the concept could be considered to be more accommodating, as it takes into account a wider variety of possible taxpayer behaviours because the elements of 'intent' and 'knowledge' (mens rea) are considered to be pre-requisites for the establishment of tax evasion behaviours (IRD, 2006).

Tooma's (2008, p. 14) study develops an excellent definition as to what tax evasion could encompass by stating:

> "*Tax evasion is the unlawful escaping of tax liability. Tax evasion involves taxpayers to deliberately misrepresent or conceal the true state of their affairs to tax authorities to reduce their tax liability. That is, evasion requires deceit on the part of the taxpayer.*"

This is the most comprehensive definition gathered for this study, and probably, the most thorough definition available for the concept of tax evasion. This definition covers not only the legality issue, but it goes beyond recognizing the behaviours from a taxpayer's perspective. That is, in order to not comply with the tax system, the taxpayer must demonstrate that they have some measure of understanding of the tax system where they can work around ways to conceal their true tax obligations (Kirchler et al., 2001 and Kasipillai et al., 2003). Tax evasion may arise from a number of scenarios, including deliberate behaviours on the understatement of income or profits, or, the overstatement of deductions and expenses (McBarnet, 1992 and McIntosh and Veal, 2001), as well as the "falsification of invoices, or making false claims to allowances" (McBarnet, 1992, p. 336).

With regard to tax evasion where 'knowledge' is required to be demonstrated by taxpayers, some studies (for example: Clyne, 1979; Bracewell-Milnes, 1980; Armstrong and Robinson, 1998; Murphy, 2005; and Gupta, 2007) have taken this concept more seriously and consider the intentional evasion of taxes to be on the same scale of seriousness as 'tax fraud'. Tax evasion has been described as a form of tax fraud, but some distinctions are still necessary to be made between the two concepts. For example, tax fraud may be considered to be more serious, complicated, and involving larger dollar amounts of unpaid taxes than tax evasion, and vice versa. Some web pages (for example: Investopedia, 2011; Brager, 2012; and Law Firms.Com, 2012) have described tax fraud in the same manner as tax evasion; where commentators state that tax fraud involve intentional failures from the taxpayers' part to file accurate tax returns.

Some web pages (for example: Department of Taxation and Finance, 2011 and Rain Minns Law Firm, 2011) have gone as far as combining tax evasion with tax fraud together by using a conjunction (for example, by inserting an 'and'/ 'or') between the two terms. Investopedia's (2011) web page state tax fraud occurs "when an individual or business entity wilfully and intentionally falsifies information on a tax return in order to limit the amount of tax liability. Tax fraud essentially entails cheating on a tax return in an attempt to avoid paying the entire tax obligation. Examples of tax fraud include claiming false deductions; claiming personal expenses as business expenses and not reporting income." Baker (2011, p. 7) describes tax fraud as a "criminal matter… [and] must involve intentional behaviour or actual knowledge of the wrongdoing," with keywords such as: knowledge, intent, and dishonesty being correlated with the concept of tax evasion. Although it may appear that these two concepts share similar characteristics between them, there are no extensive studies to date that can formally support this proposition, possibly because of the belief that this is a

subjective issue involving the perceptions and behaviours of researchers, taxpayers, tax authorities, and ultimately, how the tax system function between countries.

Not only has tax evasion been classified as a type of 'fraud', Robben et al. (1990) and Webley et al. (1991) have loosely classified 'tax cheating' as a complementary concept to tax evasion. Tax cheating has been identified by Robben et al. (1990, p. 342) as involving "deliberate acts of non-compliance which result in the payment of less tax than is actually owed… [it is the] intentional underpayment of taxes." Due to limited research conducted around the concept of tax cheating, and to an extent, tax fraud, it is still unclear as to whether it is a synonym for tax evasion or whether it is a completely new sub-category entirely that studies have yet to examine closely. This is because, Webley et al. (1991, p. 3) defined the concept of tax cheating with a slightly different approach where it considers such behaviours as incorporating "deliberate acts of non-compliance [but it] does not entail the difficulty of legal proof of tax evasion." No other literature gathered for this study mentioned the concept of tax cheating.

As the definitions for the concept of tax evasion remain inconsistent, it is still unclear to a significant degree as to whether distinct sub-categories of tax evasion can or should be formed. However, it is evident that more research is required around this area, and the dominant focus should be placed on establishing what can be acknowledged and recognized as tax evasion behaviour, rather than attempting to differentiate the possible sub-categories that may exist within tax evasion. This will allow for better contribution to literature as the classifications of sub-categories within sub-categories itself are believed to be unproductive due to the complex nature of the topic. In addition, regardless of the sub-categories that may exist within tax evasion, the illegality and knowledge aspects will not change, and by looking at just the name given to the concepts of 'tax fraud' and 'tax cheating', it is not hard to determine a possible relationship that it shares with tax evasion.

5.3.4 Over-compliance

The existing literature in the areas of tax compliance and non-compliance has been both wide-ranging and diverse. However, the concept of 'over-compliance' has not been researched to the same degree since researchers have focused primarily on other more dominant sub-categories of non-compliance. Roth et al. (1989, p. 21) define over-compliance as a form of "over-reporting [where] taxpayers report a greater liability than required." Two factors associated with the concept of over-compliance are evident from this definition: (A) complying incorrectly with tax laws, and (B) the overpayment of taxes. As there is currently very limited research conducted on this concept, the table of definitions prepared for this particular concept is extremely short.

A few studies (for example: Erard, 1997; James and Alley, 2002; Burton, 2007a; and Sung, 2009) have implicitly acknowledged that there are circumstances where taxpayers may have over-paid their tax liabilities and hence, the 'existence' of over-compliance. Despite its difference in nature with other forms of non-compliance, over-compliance is associated with situations on the 'overstatement' of tax liabilities, and thus, cannot be placed under the category of tax compliance. Nevertheless, this sub-category of non-compliance has commonly been over-looked by researchers and Inland Revenue authorities, possibly because of its 'riskless' nature to the government.

Table 5: Definitions of 'Over-Compliance'[31]

Details of Study	Definition from study	Factors considered		Additional Notes (where applicable)
		Complying incorrectly with tax laws	*Over-payment of taxes*	
Roth et al. (1989)	The taxpayers report a greater liability than required.		√	Either intentionally or unknown to the taxpayer at the time.
Webley et al. (1991)	Does not assume that an inaccurate tax return is unnecessarily the result of an intention to defraud the authorities and it recognizes that inaccuracies may result in the overpayment of taxes.	√	√	Recognizes over-compliance by stating that there may be instances where non-compliance is the result of the overpayment of taxes.
Burton (2007a)	Arises where a person does not comply with a legal obligation and this produces an advantage to the revenue.	√	√	This definition does not capture the essence of over-compliance as this particular behaviour usually arises in situations where taxpayers believe they have complied with relevant legislations.

Armstrong and Robinson (1998, p. 332) believe over-compliance situations to be "rare", causing the focus of research on other forms of non-compliance (under-compliance). Within their study, they describe briefly the concept of 'excessive compliance'; where it is defined as situations where "some taxpayers, whether from the fear of the Inland Revenue, loyalty to the government, laziness, or some other reason, strive to comply with their perceived intent of all the tax laws" (Armstrong and Robinson, 1998, p. 331). Based upon this definition, some may

[31] Online tax refund tax companies help taxpayers to obtain their legitimate refunds, but they do not specifically define the over-compliance concept itself.

mistake it as the definition intended for the concept of tax compliance where taxpayers are complying with the 'letter' and; to an extent, the 'spirit' of the law.

However, the second part of the definition from Armstrong and Robinson's (1998, p. 332) study states that "if the motivation is fear, the taxpayer may be straining the virtue of justice, since s/he is demanding more taxes out of her/himself than is required of other taxpayers in similar situations." The possible reasons associated with 'excessive compliance', whether or not a complementary term to over-compliance, can be interpreted as causes for over-compliance, rather than an explicit definition for the concept. It can be viewed that excessive compliance reflects situations where taxpayers have paid more taxes than what is required from them, and over-compliance represents situations where taxpayers did not obtain their entitled tax refunds at the end of the year to bring the balance back to zero. Either way, confirmation from other studies is still required to determine whether excessive compliance is intended to hold the same definition/understanding as over-compliance or whether it is a completely different concept.

Possible causes of over-compliance were suggested by Andreoni et al. (1998, p. 822) where people "tend to overestimate both the probability and magnitude of penalties [and possibly the audit probability], or may fear social stigma or damage to their reputation if they are exposed as cheaters." Arora and Gangopadhyay (1995) also looked at factors concerning *wh*y some people prefer to over-comply from a business environmental regulations perspective. Although the study failed to provide an explicit definition for the concept of over-compliance, it did find that reasons of reputation or anticipation of stricter future regulations have the potential to 'encourage' over-compliance. Although both of these studies acknowledge situations where over-compliance may be considered as having a prominent existence within the area of non-compliance, they both failed to define the concept.

Nevertheless, the studies provide a solid foundation as to what factors are associated with the problem of over-compliance, and this contributes to the understanding of the over-compliance problem in the future when working towards the goal of finding an appropriate definition for the concept.

Burton (2007a, p. 1) studied the area of over-compliance in great depth where he argues, "the 'compliance pyramid'… adopted in both Australia and New Zealand - suffers from significant short-comings," as it fails to consider the area of over-compliance from the perspective of taxpayers.[32] Unlike other forms of non-compliance, where it is the government that suffers from uncollected tax revenues, over-compliance means that it is the taxpayers that suffer, either because of a lack of tax knowledge, or the belief that the tax refund process is too "daunting" (Timaru Herald, 2008 and Forbes, 2009).

Over-compliance is a relatively new concept when compared with other sub-categories of non-compliance, but the concept itself should not be perceived as a 'new' area of focus as the issue has existed in tax returns in the US since the 1980s (Burton, 2007a). In addition, Burton (2007a, p. 2) notes that it has been found in recent literature that there are incidents in Ireland where "taxpayers failed to claim tax benefits to which they were entitled, resulting in [the] overpayment of tax." As a result, this raise a possibility that taxpayers from around the world may, for a number of reasons, be paying more tax than is legally required/expected, where they miss out on legitimate tax refunds in various circumstances.

This is especially evident in New Zealand's context where there is a self-assessment regime, and not all taxpayers are required to file an annual tax return. As mentioned in Chapter 2, New Zealand has a self-assessment regime where it has undoubtedly collected more tax from wage and salary taxpayers than before the legislative change, if they do not

[32] See Figure 1 from Chapter 2 for the Compliance Model adopted by the Inland Revenue Department.

file annual tax returns at all. For example, it has been estimated by online articles that uncollected refunds from year 2000 onwards are at a whooping $700 million (Morall, 2008 and Timaru Herald, 2008). The figure of $700 million was derived from, "a combination of miscalculated deductions from salaried employees and wage earners, missed exemptions and rebates, and an overall lack of awareness about the opportunity to set the record straight" (Morall, 2008). The lack of the 'awareness' feature raises an interesting factor where it may represent as one of the important factors associated with over-compliance because if taxpayers had the knowledge that they are over-complying, then it is highly unlikely that situations of over-compliance would continue to exist.

The Inland Revenue Department's (IRD) website provides an online calculator for individuals to determine whether they are due for a tax refund, but online tax refund companies are becoming the more popular choice. The various online tax refund companies are useful tools for finding out whether a refund is due as they are situated in convenient mall locations around the country, but they do not provide explicit definitions for the concept of over-compliance as it only recognizes the fact how taxpayers may have 'over-paid' their tax obligations and therefore, the need for them to claim tax refunds.

New Zealand Tax Refunds Limited is a popular online tax refund company, and because of the self-assessment regime, the company showed a "1401 percent revenue growth in the period to March 31, 2011" (Wood, 2011). This company (along with other online tax refund companies) promotes a faster, easier and risk-free form of filing a tax return where taxpayers will find out "within 60 seconds" and get their eligible refunds deposited into their bank account "within 2 days" (Anonymous, 2011). By utilizing the calculator provided by an online tax refund company, taxpayers will need to pay a percentage of their refund (usually

around 20 per cent) in the form of fees to the refund company, and this may seem unfair to some taxpayers where they have to pay for getting what was rightfully theirs back.[33]

The focus of this study is not to emphasise how online tax refund companies are expanding at an alarming rate, but at the high percentage of taxpayers who utilize these online tools and how much taxpayers would actually receive if they had taken the time and effort to file a tax return. New Zealand Tax Refunds have found that "93 percent of their customers have overpaid their tax in the past five years and the average customer refund for 2011 is $339" (Anonymous, 2011). This reflects the perceived complexity of the tax law in New Zealand and how over-compliance issues and the concept itself are often over-looked by tax authorities.

Unlike problems associated with other forms of non-compliance, over-compliance problem only affects certain groups of taxpayers (especially younger people and those that have had a significant change in their income level over the year), thus the limited number of research conducted around this concept. But for the articles that have been gathered for this study, similarities are apparent between them where they have provided several reasons for contributing to the problem of over-compliance; however, due to the lack of evidence available to date, one cannot objectively determine whether this particular action is 'acceptable' or 'desirable'. Nevertheless, more attention should be taken by taxpayers to pay only the correct amount of tax (not more, not less), and revenue authorities should be more pro-active in assisting taxpayers to obtain their eligible refunds, other than providing an online calculator and the distribution of pamphlets regarding the tax refund process.

[33] Taxpayers will not be charged a fee if they are not due for a tax refund. That is, taxpayers will only pay if they are due for a refund, with the commission rate varying between companies and the amount of refund due.

The calculator provided by online tax refund companies, and the documents provided by the IRD do not explicitly define the concept of over-compliance, but they do act as a means of counteracting the problem, and to an extent, 'encourage' taxpayers to only pay the 'correct' amount of tax. As with other forms of non-compliance where it is unavoidable and lead to the 'underpayment' of taxes, the issue of over-compliance is likely to continue into the future for as long as the self-assessment regime is in place and if taxpayers continue experiencing problems comprehending tax laws and regulations. As a result, it seems there may be a long time before the characteristics associated with over-compliance can be combined to form a 'universal' definition for the concept.

5.4 Studies That Do Not Define Tax Compliance and Non-Compliance

As noted in the earlier chapters of this study, a significant number of existing studies have not explicitly defined any of the concepts of tax compliance, non-compliance, and their sub-categories. After some extensive research, it is believed that the reasons for this can generally be divided into three main categories; with each of them described in this section.

First, a high proportion of studies that do not define the concepts were set out to examine the issues of tax compliance and non-compliance, and they have focused primarily on what *factors* or *models* influence the behaviours of tax compliance and non-compliance. For example, the studies by Wenzel (2002), Taylor (2003), Kirchler et al. (2008) and Kastlunger et al. (2010) are all studies that have emphasized on how norm processes, gender difference and the development of frameworks for tax compliance influence a taxpayer's attitude towards the tax system, and ultimately, their compliance behaviour. The study of how gender differences affect a taxpayer's compliance behaviour by Kastlunger et al. (2010) acknowledges that ethical standards, audit probabilities, and gender are all important factors to consider whilst studying the level of compliance by men and women. Apart from the focus

on gender differences, Ho and Wong (2008) focus on how ethics can influence compliance behaviour. They conducted their study by focusing on individual taxpayers in Hong Kong, as well as reviewing existing literature within the ethics domain. Despite the absence of definitions for tax compliance and non-compliance, the study by Ho and Wong (2008) did analyze how different frameworks and models can enhance a researcher's understanding and application on the area of behavioural tax compliance and non-compliance. Lastly, Devos (2006) conducted a comparative analysis between New Zealand and Australia's tertiary students on their attitudes towards non-compliance, and particularly, tax evasion; while Marriott et al. (2010) studied the causes and consequences of tax evasion but also failed to provide an explicit definition for the concept of tax evasion. However, this paper does acknowledge the effects of tax evasion by stating that such behaviour "contravenes fiscal equity and can distort international competition and capital flows" (Marriott et al., 2010, p. 369).

This approach has proven to be popular as a number of other studies[34] have also adopted this approach if their objective of study had been to study/evaluate factors and models that influence tax compliance behaviours, rather than placing a focus on how a particular concept of tax compliance and non-compliance should be defined.

In addition, studies by Crane and Nourzad (1992) and Sheffrin and Triest (1992) not only examined the impact variables have on the level of compliance behaviour, but they also adopted different models to examine levels of tax compliance behaviour. These studies did not produce a definite understanding of what the concepts of tax compliance and non-compliance meant, but through the examination of such models, they concluded that there are different perspectives available for the study on behavioural tax compliance and non-compliance. For example, Sheffrin and Triest (1992) implemented an economic model of tax

[34] For example, studies by: Hasseldine (1998), Chan et al. (2000), Picur and Riahi-Belkaoui (2006), Richardson (2006), Lavoie (2008), Damjanovic and Ulph (2009), and Leder et al. (2010) have adopted similar approaches to Ho and Wong's (2008) study.

compliance where it considers that there are sociological (social norms) and psychological (individual attitudes) perspectives for determining issues associated with tax compliance.

Second, from the level of existing literature within this area, it would be unsurprising to come across studies that have replicated previous studies. This can be achieved by either expanding or extracting main points of focus from a particular study to further produce a more updated and comprehensive version of that particular study. This is especially evident from Jackson and Milliron's (1986) study on the various behavioural factors where it has been used as a foundational study by many researchers over the years. For example, the study by Richardson and Sawyer (2001) updated and expanded Jackson and Milliron's (1986) study by reviewing developments in the literature over the years on how taxpayers' behaviour may be influenced by various factors.

Furthermore, as a result of many researchers adopting prior literature as a starting point for their own study, some researchers have also 'transferred' the definitions of the concepts over to their own study. For example, Braithwaite (2003a) adopted James and Alley's (1999) version of the definitions for the concepts of tax compliance and non-compliance into its own study. This shows that although the topic of behavioural tax compliance and non-compliance may be broad, there are bound to be some similarities between studies, and rather than creating a 'new' definition that may not necessarily supersede the comprehensive effectiveness of an existing definition, then why not maximize the effect a particular form of definition may bring for the concepts of tax compliance and non-compliance?

Third, due to the approach taken by the researchers, some studies have given examples for the concepts of tax compliance and non-compliance instead. By providing examples of what behaviours contribute to the categories of tax compliance and non-compliance, this provides readers with some insight as to what the researcher was trying to

achieve and convey within their study. The study by Braithwaite (2003a) did not include any explicit definitions for the concepts but instead, offered some good examples that are related to non-compliance and tax evasion. For example, Braithwaite (2003a, p. 33) describe several possible actions that may lead to tax evasion, including the "non-lodgement, non-payment of tax debt, failure to declare income, provider of cash-in-hand services, purchaser of cash-in-hand services, and over-claiming deductions."

This may be perceived as a more effective way for promoting what amounts to tax compliance and non-compliance as some existing definitions may not be as comprehensive and accommodating when compared with studies that provide a list of examples instead. This is especially evident in studies that offer very limited understanding of what is meant by the concepts as some definitions are short and do not capture the essence of what the concepts are supposed to incorporate. In addition to providing examples of what some of the concepts are generally known by researchers, some studies have also provided a list of possible actions that can amount to either tax compliance and non-compliance behaviours. Carroll (1992, p. 44) states, non-compliance can result from situations where the "taxpayer is ignorant, lazy, careless, deliberately cheating, following common practices in occupational groups of workplaces, heeding incorrect advice from the IRS, making a symbolic protest against the tax system or the uses of money…"

As opposed to providing examples of what amounts to a specific type of tax compliance or non-compliance behaviour, Baker (2011) outlined the three key terms, consisting of: tax avoidance, tax evasion and tax mitigation, where the paper was set out to examine why a clarification should be made between the concepts. However, the study lacks clarity as to what the concepts actually mean because it did not provide explicit definitions for each of the key concepts. Nevertheless, the study did recognize that if the concepts are placed on a spectrum; then tax mitigation is acceptable, and tax evasion is similar to tax fraud

as it requires intent or knowledge from the taxpayer's behalf. As well as describing the through a 'spectrum of conduct', the study also utilized some case law judgments that are related to the concept of tax mitigation. However, based on the objective set out from Baker's (2011) study, some form of definition for the concepts was expected.

The studies that provide examples as opposed to defining the concepts do not make them less valuable to the literature we have available within this area. They simply provide a different perspective on how the complicated problem can be tackled by researchers. It may be argued that it is not as productive to attempt to 'build' a definition if the issues relating to the categories within tax compliance and non-compliance cannot be reduced to a further extent. In addition, it may also be perceived readers that by providing examples of what amounts to certain behaviours of tax compliance and non-compliance, those studies are still making progress with the attempt to reduce the level of confusion that may arise between the sub-categories of tax compliance and non-compliance. There are of course other reasons as to why some studies do not explicitly define the concepts of tax compliance and non-compliance, and this section has only provided a few of the possible main causes on why this may have been the case.

6.0 A Critical Review of the Research Results- New Zealand Case Law

6.1 Introduction to New Zealand Case Law

New Zealand's tax system requires its taxpayers to voluntarily comply with their tax obligations. However, not all taxpayers are honest with their tax affairs, and this has led to a number of tax avoidance and tax evasion related cases. The following section discusses recent examples of New Zealand case law and in order to provide a clearer picture on the issue, it is separated under the main headings of tax avoidance and tax evasion.

6.2 Tax Avoidance Cases

Section BG 1 from the Income Tax Act 2007 ("ITA 2007") is the current core general anti-avoidance provision because it applies to arrangements that have been entered into with the purpose or effect of avoiding tax. This statutory section is commonly the first step taken by the Courts to establish whether it is a tax avoidance case. The distinction between tax avoidance and tax evasion may not always be easy to establish but in *Peterson* (Privy Council, 2006, paragraph [60])[35] , the court stated that "the line to be drawn between 'tax evasion' and 'tax avoidance' is clear enough. The former is criminal. The latter is not. It may be socially undesirable but it is within the letter of the law."

In order to invoke section BG 1, it is important to identify whether there was an arrangement. If section BG 1 applies, then the tax avoidance arrangement is void against the Commissioner for income tax purposes. The Supreme Court from *Ben Nevis* (2008, paragraph [106]) describe the function of section BG 1 as a section that is intended to

[35] *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433 (PC).

"prevent uses of the specific provisions which fall outside their intended scope in the overall scheme of the Act. Such use gives rise to an impermissible tax advantage which the Commissioner may counteract." The statutory definitions for 'arrangement', 'tax avoidance', and 'tax avoidance arrangement' are set out in section YA 1 of the ITA 2007 (see Appendix B). In case law, the emphasis has been placed on examining the purpose and effect of the arrangement itself, and not on the taxpayers' intentions (Coleman, 2009).

Looking at the legislation itself, it is clear that the "Parliament has not provided an exhaustive definition [for tax avoidance] and has left it to the courts to identify tax avoidance." (IRD, 2011f, paragraph [11]). This is supported by the judgment from *Ben Nevis* where it was agreed that the general anti-avoidance provision has been left "deliberately general" by the Government (*Ben Nevis* Supreme Court, 2008, paragraph [112]). Furthermore, Coleman (2009, p. 33) states that the "general anti-avoidance provision is thus seen as being intended to support, not override other provisions of the income tax legislation."

The limitation on the scope of how section BG 1 can be interpreted in court and by the taxpayers, and what tax avoidance incorporates, has caused a significant level of confusion under different circumstances as there is often a narrow distinction between acceptable tax minimization and unacceptable tax avoidance.[36] As a result, there is a tendency for the courts to formulate their own (extended or amended) definitions of tax avoidance.

[36] For example, in *Penny and Hooper*, it was held by the Supreme Court that there was a tax avoidance arrangement due to the setting of the artificially low salary levels to the taxpayers. Whereas, the High Court in *White* held the setting of low or no salary level to White was not artificial or contrived, thus not a tax avoidance arrangement.

In contrast to the various forms of definitions for the concept of tax avoidance, it is believed that the term 'arrangement', as set out in section YA 1, is widely defined as it "provides for varying degrees of enforceability and formality" (IRD, 2011f, paragraph [165]). It is a term that has been defined to cover the various means between two or more parties on their plans and the effect of those actions (see *Newton*, 1958; *Peterson*, 2006; and *BNZ Investments Ltd*, 2009).[37] Unlike tax evasion, 'knowledge' is not a factor that is required to be present, and thus, it is possible under tax avoidance scenarios that one party may not necessarily know about the tax avoidance aspects of the arrangement (as seen in *Peterson*, 2006).

The facts of a particular case play an important role in determining the outcome of the case, therefore creating a conflict as to what the concept of tax avoidance may entail as there is no one pre-defined 'universal' definition for the concept. Elliffe (2011, p. 461) state "one of the tensions existing in tax avoidance arrangements is that they often have the very same presence of non-commerciality, concealment, and artificiality which have featured in some of the criminal prosecutions involving deceit and evasion." This raises the difficulty involved in distinguishing between tax minimization and tax avoidance; and tax avoidance and tax evasion.

In addition to the difficulties involved between legal and illegal tax planning activities, there is also a necessary distinction to be made between tax mitigation and tax avoidance. It was made clear in *Challenge* (Privy Council, 1986)[38] that tax mitigation is not captured under section 99 (now section BG 1) because "the taxpayer's advantage is not derived from an arrangement, but from the reduction of income which he accepts or the expenditure which he incurs" (Dunbar, 2006, p. 354). Tax mitigation was discussed in

[37] *BNZ Investments Limited & Ors v The Commissioner of Inland Revenue* [2009] HC WN CIV-2004-485-1059.
[38] The Privy Council was been replaced by the Supreme Court from January 2004.

Chapter 5.3.2.1. under tax avoidance but from a case law perspective, it may not necessarily be correct to treat the term in the same manner as tax avoidance if it could not be captured under section BG 1, but it is reasonable to conclude that it is indeed an unhelpful term as there is usually a very fine line between what constitutes as acceptable tax minimization (and thus tax mitigation) and tax avoidance.

6.2.1 Tax avoidance defined

Elliffe and Cameron (2010, p. 453) see tax avoidance as schemes that are "cleverly designed to fit within the words, and increasingly, particular schemes of the Act." This statement may be translated as taxpayers as complying with the black letters of the law, but not suffering from the economic burden of the transactions; or more commonly known as: challenging Parliament's intention (or contemplation). Orow (1995b, p. 318) believes cases of tax avoidance in general involve "an artificiality criterion [that] has often been considered to play a significant if not critical role in determining the true character and legitimacy of transactions for tax purposes." In other words, a tax avoidance case involves the legal effect and consequences of an arrangement. Tax avoidance arrangements are different from shams as shams have been "created and constructed in such way so as to create false impressions of its true legal character and as such are void in law" (Orow, 1995b, p. 318). Furthermore, Prebble (1996, p. 62) reinforces the difference by stating that a sham is "often designed to hide other forms of fraud… Despite having entered into a transaction that is a sham, a taxpayer may correctly report his income… one reason for constructing shams is to hide transactions that evade tax." The distinction between a tax avoidance arrangement and a sham was later applied in *Ben Nevis* (Supreme Court, 2008), as illustrated in Chapter 2. Apart from the economic substance and reality of the agreement between a tax avoidance arrangement and a sham, it may be argued that a sham is highly deceitful as it does not reflect the real agreement that the parties had initially intended, thus leaning towards acts of evasion because

of its dishonest nature. The draft Interpretation Statement on tax avoidance (IRD, 2011f, paragraph [21]) gives a classic definition of tax avoidance by stating that it is:

> "*An arrangement structured so the taxpayer gains the benefit of the relevant provision in an artificial or contrived way. An arrangement may be artificial if it has been structured to ensure the provisions of the Act are applied to its legal form in a way that does not reflect the commercial reality and economic effects. High levels of complexity or unusual commercial practice may also, but will not necessarily, indicate that an arrangement is artificial or contrived.*"

This is a comprehensive tax avoidance definition, but it is not often this thoroughly defined in case law scenarios. For example, *Ben Nevis* (Supreme Court, 2008, paragraph [107]) states that tax avoidance arises when the taxpayer has used specific provisions, "and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision." These two definitions of tax avoidance both (implicitly or explicitly) raised the 'artificiality' factor that is commonly found in tax avoidance arrangements.

However, it is not a term that is defined in the legislation, so it creates uncertainty about what the concept actually means or covers "and this is therefore not the most principled way to approach the issue" (Trombitas, 2009, p. 356). Nevertheless, it is believed that a tax avoidance arrangement could entail one or more factors of the following factors, for example:

> "*Artificiality, contrivance, pretence, circularity of funds, timing mismatches, unnecessary insertion of steps into a transaction, lack of a business purpose, a divergence between the economic and legal effects of a transaction and dealings between non-arm's length parties…*" (Elliffe and Cameron, 2010, p. 451).

6.2.2 Approaches and principles adopted by the Judiciary

As there is no comprehensive statutory definition for the concept of tax avoidance, the courts often have to go through the process of applying and adopting certain approaches and principles in order to determine whether a particular arrangement constituted tax avoidance. Although the approach and principle themselves do not explicitly define the concept of tax avoidance, they serve as a helping tool for ascertaining what tax avoidance may entail, as the facts of each case are both unique and incomparable.

The approach taken for determining whether an arrangement was outside Parliament's contemplation is a useful tool adopted by the courts for deciding whether a particular behaviour constitutes tax avoidance. Based on *Ben Nevis* (Supreme Court, 2008), if an arrangement is not implemented in a manner that is consistent with Parliament's purpose, then it would be considered as a tax avoidance arrangement. The approach takes into account the economic effects and the commercial reality of the arrangement, and thus is able to identify the parties involved and those affected by the particular arrangement (IRD, 2011f).

In Case *W33* (2004),[39] the dentist's salary had been fixed from his corporate trustee at a significantly lower figure than prior to the setting up of the trusts resulting in a significant amount of tax saved. The dental practice had been carried on essentially as it had before; leading it to be a tax avoidance case as there is a lack of commercial reality in the setting up of a family trust (as opposed to the practice being owned by a partnership). Therefore, "if, after understanding the commercial and economic reality, the tax outcomes sought, based on the legal form of the arrangement, are not what Parliament would have intended, the arrangement will be outside Parliament's contemplation [and thus, a tax avoidance arrangement]" (IRD, 2011f, paragraph [227]). The decision reached in *Penny and Hooper* is

[39] *Case W33* (2004) 21 NZTC 11,321 (TRA).

consistent with this case, hinting that the Judiciary continue to emphasis on certain main points when determining whether it is tax avoidance.

An example where the taxpayers had not suffered the economic burden intended by Parliament would be the *Glenharrow* (Supreme Court, 2008)[40] case where it involved the issue of the purchase price of a second-hand mining licence. The value of the mining licence was considered by the courts to have been grossly inflated at $45 million. It was genuinely believed by Glenharrow that the arrangement with Mr. Meates (the seller) was in accordance with the overall purpose of the Good and Services Act 1985 ("GST 1985") as it had only met the black letter requirements, and so the court believed that the arrangement was not consistent with the intent and application of the GST 1985, and thus a tax avoidance case.

Another example is evident from the *Penny and Hooper* (Supreme Court, 2011) case where it was held by the Judges that the artificially low salary levels fixed for Messrs Penny and Hooper could not have been what Parliament had contemplated (and thus tax avoidance), even though what is considered to be a 'commercially realistic salary' for orthopaedic surgeons is not separately defined in the legislation. In order to establish whether it was a tax avoidance arrangement, the monetary amount gained by the taxpayers is irrelevant for determining whether section BG 1 applied. From what the Courts have established over the years (for example: see *Marx v CIR*[41]*; Carlson v CIR*[42] and *Penny and Hooper*), it is evident that a tax avoidance arrangement can exist even if the tax advantages gained are insignificant in monetary value as section BG 1 applies to the facts of the case, and not the financial advantage obtained by the taxpayers (Dunbar, 2006). However, tax avoidance case law demonstrates a trend similar to the one found in tax evasion cases where the financial amount

[40] *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* (2008) 24 NZTC 23,236 (SC).
[41] *Marx v Commissioner of Inland Revenue*; *Carlson v Commissioner of Inland Revenue* [1970] NZLR 182 (CA).
[42] *Marx v Commissioner of Inland Revenue*; *Carlson v Commissioner of Inland Revenue* [1970] NZLR 182 (CA).

gained by the taxpayers are usually significant, and the amount is likely to have been 'saved' over a period of time (see Chapter 6.3.2. The 'Degrees' of Tax Evasion).

Another common (but similar) principle adopted by the Judiciary for determining whether there is a tax avoidance arrangement is by distinguishing between the purpose and effect of an arrangement. If there is more than one purpose within an arrangement, then the dominant purpose (as opposed to the merely incidentals) is the main focus for determining whether it is a tax avoidance arrangement. In *Penny and Hooper*, it was concluded by the Supreme Court (2011) that the tax advantages gained were not merely incidentals and thus, they were engaged in a tax avoidance arrangement because of the lack of economic reality in the setting up of family trusts to avoid negligence claims (see Chapter 2 for more details).

As a result of the lack of commercial explanation in *Penny and Hooper*, the Judiciary have now adopted a stricter approach for assessing whether the tax advantages gained by taxpayers have a dominant economic aspect to it. If not, then it is highly likely that one can confirm the existence of tax avoidance. Economic reality can be said to exist when there is a commercial effect to the arrangement, that is, taxpayers have utilized the tax incentives whilst objectively taking into account the context and purpose of the legislation (Elliffe and Cameron, 2010). However, this distinction is not always easy for taxpayers to follow because of the uncertainties and loopholes in certain areas of tax law (*Ben Nevis* Supreme Court, 2008).

Tax avoidance was deemed to have existed in *Krukziener* (High Court, 2010)[43] where Krukziener paid no tax over the years as he had been living off loans taken from his various companies. Courtney J was dissatisfied with the argument that there was no arrangement as the loans were genuine liabilities where no income tax was payable. It is stated in paragraph

[43] *Krukziener v Commissioner of Inland Revenue* [2010] HC AK CIV-2010-404-000728.

[23] that "a significant indicator of the existence of an arrangement was the fact that the current account advances were repaid only when non-taxable distributions became available," therefore, the lack of economic reality within the arrangement itself and the financial advantages gained by Krukziener confirms it as a tax avoidance case.

The importance of the economic reality of an arrangement emphasized by the courts confirms this aspect as a critical factor to consider as to whether it is indeed tax avoidance. This approach is evident through two cases. First, *Russell* (Court of Appeal, 2011)[44] is a case associated with the implementation of the 'Russell Template', it is a scheme that involves "entities controlled by Russell purchasing a profitable trading company (or companies) from the client…which the client continued to run as if no ownership change had occurred [so that no tax is paid]" (*Russell* COA, 2011). The courts confirmed the execution of the 'Russell Template' to be a tax avoidance arrangement due to the high level of artificiality associated with the steps taken within the arrangement that is carried out by the parties involved.

Second, the structured finance transactions through the use of a template, known as 'repo'[45] deals that were constructed in *BNZ Investments Ltd* (High Court, 2009) was also considered as a tax avoidance arrangement. The 'repo' deals were believed to have "no commercial rationale, logic or purpose" (*BNZ Investments Ltd* HC, paragraph [512]), because of its "lack of business substance" (*BNZ Investments Ltd* HC, paragraph [515]), and thus the decision that it was a tax avoidance arrangement.

[44] *Russell v The Taxation Review Authority* [2011] NZCA 158, (2011) 25 NZTC 20-044.

[45] The 'repo' deals essentially meant that the "transactions were structured to enable the New Zealand banks to deduct the cost of borrowing, the guarantee fee expense and the net cost incurred in the interest rate swap. The New Zealand banks would treat the distributions it received as tax exempt income, either as distributions received from an overseas owned company, or under foreign tax credit provisions" (Sawyer, 2009, p. 13).

Lastly, *Alesco* (High Court, 2011)[46] is a recent tax avoidance case where the arrangement between the parties lacked a commercial purpose. The case involved Alesco's purchase of two New Zealand companies through the use of a structure called 'optional convertible notes' (OCNs) to fund the purchase. The OCNs are a hybrid debt-equity financial instrument, and although no interest was payable to Alesco, they claimed interest deductions. The court stated that under the situation where no real economic cost was borne by the taxpayers, there is no commercial purpose other than to obtain a tax advantage (*Alesco* HC, paragraphs [134] and [135]), thus, outside Parliament's contemplation (*Alesco* HC, paragraphs [94] and [147]).

Therefore, although the concept of tax avoidance is not always defined within case law judgments, but through the application of the statutory definition provided in the ITA 2007 and the relevant principles and approaches taken by the Judiciary, there is a solid explanation for what may be considered as tax avoidance. Apart from the legal steps taken to minimize one's tax liabilities, the importance to identify the presence of an arrangement is also an important factor in case law scenarios. The application of the statutory definition for tax avoidance and what constitutes as a tax avoidance arrangement alone does not thoroughly explain the boundaries of the concept, but with the help of the approaches and principles adopted by the courts over the years, there appears to be a growing trend for an in-depth examination (and debate) on the *purpose* and *effect* of an arrangement and if certain factors are met, then the Judiciary can generally conclude that it is a case of tax avoidance. Apart from the approaches and principles adopted by the courts over the years, it is evident that there lacks the number of definitions available for the concept itself, but the considerations made by the Judiciary and the descriptions provided by them are seen as useful tools for understanding what the concept of tax avoidance may incorporate.

[46] *Alesco New Zealand Ltd and Ors v Commissioner of Inland Revenue* [2011] HC AK CIV-2009-404-2145.

6.3 Tax Evasion Cases

The existing literature gathered for this study clearly describe how the concept of tax evasion is usually defined, by noting that it involves illegal, deliberate acts to avoid meeting one's tax obligations. As a criminal act, acts of tax evasion usually lead to either civil or criminal penalties, including imprisonment.

*Taylor (*Supreme Court, 1963)[47] shows that the mental element in evasion can vary, and at a minimum, a deliberate intent to not pay tax. McGregor J in *Taylor* said "the word "evade" associated with the expressions "attempts to evade" or "does any act with intent to evade" includes an element of intent, that is, "an intention to endeavour to avoid payment of tax known to be chargeable" (*Taylor* Supreme Court, paragraph [262]). This definition was later adopted in *Dhillon* (Court of Appeal, 2009)[48] and *Tonks* (Court of Appeal, 2011). In addition, Coleman (2009, p. 11) state tax evasion is deemed to have occurred when "there is a statutory obligation to disclose one's income and the taxpayer deliberately understates their income…" Lastly, *Fepuleai* (Court of Appeal, 2008)[49] provide a comprehensive definition for the concept of tax evasion by stating:

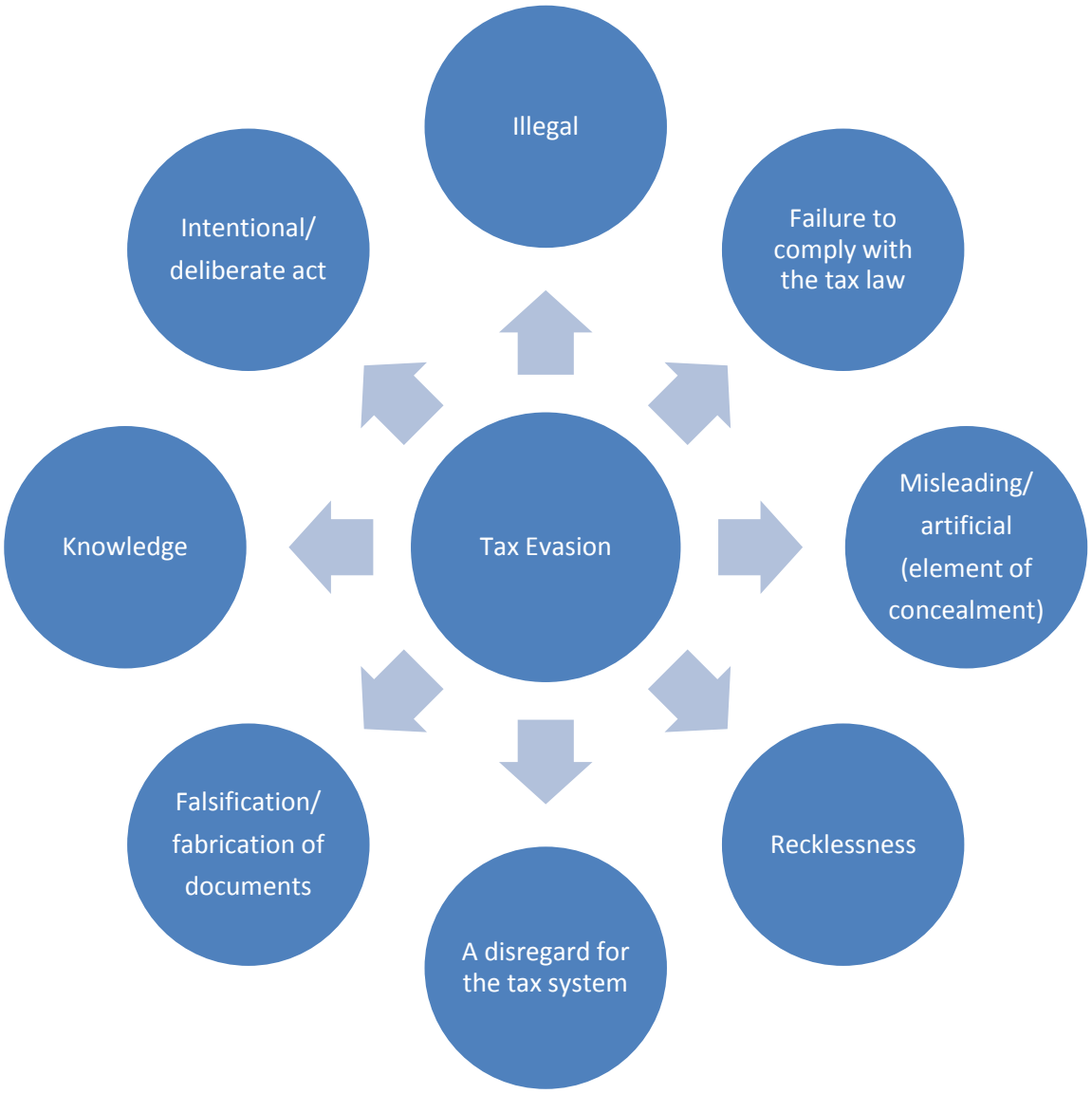
> "*…What does "evasion" mean? …There has got to be an element of wilfulness, it's more than a mere failure to account or pay as a result of an accident or a mistake, it is more than omission or neglect…It involves an intention to avoid assessment or payment where there is an obligation to pay tax or file a return. That is, an intent to endeavour to avoid the assessment or payment of tax where there is an awareness that the assessment must be made or that the tax is payable*" (paragraph [27]).

[47] *Taylor v Attorney-General* [1963] NZLR 261 (SC).
[48] *R v Dhillon* [2009] CA319/2009 NZCA 597 (CA).
[49] *R v Fepuleai* [2008] CA689/07 NZCA 339 (CA).

6.3.1 The characteristics of tax evasion

A number of recent cases have been examined from the Inland Revenue Department's web pages where it is clear that acts of tax evasion require, at a minimum, the establishment of the 'knowledge' factor, along with at least one other factor from the following diagram (Figure 2).

Figure 2: The Characteristics Associated with Acts of Tax Evasion



The characteristics identified above represent the 'foundations' or 'requirements' necessary to establish that tax evasion behaviour has occurred, with the 'knowledge' and 'intentional' factors being the most crucial factors among them. However, these characteristics are not usually accounted for in the definitions for the concept of tax evasion as they are commonly viewed as ways of examples where tax evasion begins. Section 141E of the Tax Administration Act 1994 ("TAA 1994") set out various acts or omissions which would constitute a similar act to evasion (IRD, 2006), and if breached, the taxpayer will be required to pay the appropriate penalties, as outlined in sections 143-143B. However, the concept of tax evasion is not specifically defined in the TAA 1994. In order to intentionally evade tax liabilities, the taxpayer must have knowledge of the situation that they are not being 100 percent honest to the Inland Revenue authorities. Apart from the legality factor, it is evident that the 'knowledge' factor is what sets tax avoidance behaviours distinct from acts of tax evasion.

After establishing that the 'knowledge' factor has been satisfied, a taxpayer is deemed to have involved themselves in tax evasion behaviours by adopting one or more of the factors outlined in Figure 2. For example, Ms. Emanuel (IRD, 2011d) had received notifications from the Inland Revenue authorities to provide her business activities to support her GST claims, but she claimed she had lost them "when she was moving house and she could not reconstruct these records either" (IRD, 2011d), but instead, she later provided "altered, false, incomplete, or misleading information" (IRD, 2011d) on those GST returns. This showed that Ms. Emanuel had knowledge that she was providing misleading information to the Inland Revenue authorities by providing false information. Mr. Pongi (IRD, 2011b) was another taxpayer (in a separate incident) who had intentionally decided to not comply with relevant tax obligations by not filing any GST or company returns when he was "well aware of his responsibilities" (IRD, 2011b).

Tax authorities identify tax evasion behaviours to be serious and by deliberately trying to evade meeting one's tax obligations, the taxpayer must be occupied in 'calculating' ways to avoid complying with the tax rules even though they are aware of what is expected from them from a compliance perspective. Another example could be seen from Mr. Haggie's case (IRD, 2010b) where he deliberately ignored notices from the Inland Revenue authorities and even disappeared from his known address to avoid filing honest tax returns. These three cases have all satisfied the requirement of the 'knowledge' factor required to establish that it is an act of tax evasion where they knew they have not met all of their tax obligations, and in one way or the other, have *deliberately* done something to conceal their acts of under-compliance.

An interesting case was heard at the New Plymouth District Court in 2010 where Mr. Blackman "deliberately set out to try and cheat the tax system by failing to declare income" (IRD, 2010a). His intentional behaviour of attempting to avoid tax payment was not the only issue presented to court, it was also his "ridiculous, hollow argument over his supposed lack of understanding of the '$' symbol…" (IRD, 2010a). Despite his lack of understanding of the symbol, his obligations remain unchanged, where he was fined for knowingly not declaring his income.

Apart from the common cases of deliberately not disclosing accurate tax returns to the Inland Revenue authorities, there has also been cases where behaviours of tax evasion (or fraud) can be found through "a complex structure of associated companies and trusts" (IRD, 2009a). However, it is not the only determinant for tax evasion in this case as Mr. Duncan was also involved in claiming GST deductions for fictitious transactions that either never occurred, or were later cancelled. There have also been cases where taxpayers have attempted to claim deductions and/or refunds on fictitious purchases of a helicopter, livestock purchases

(IRD, 2008c); frivolous personal reasons (IRD, 2008b); false loan applications (IRD, 2008a); and fabricated documents on the purchase of various musical instruments (IRD, 2008d).

These are only a few of the recent examples of case law where taxpayers have been deemed to be involved in tax evasion (or similar acts). It is evident that tax evasion may be found in a number of possible situations and the difference between case law scenarios compared with existing literature is its abundance number of examples, as opposed to only mentioning its 'illegality' and 'deliberate' characteristics. It is from the behaviours of taxpayers described in case law that we understand what characteristics may contribute for a taxpayer to be engaged in evasion-related activities. The seriousness of each offence is not considered within this study as it is not the intention of the author to examine the appropriateness of the penalties imposed for tax evasion. However, it has been a feature of this study to look at the 'degrees' of tax evasion and how they are distinguished between one another under different circumstances.

6.3.2 The 'degrees' of evasion

As with the discussion on the concept of tax compliance where it is reasonable to conclude that there are 'layers' of compliance, tax evasion case law has also adopted the approach of distinguishing between 'innocent' and 'fraudulent' evasion. Lord Templeman from *Challenge* (Privy Council, 1986, paragraph [513])[50] explains that evasion occurs in situations when "the Commissioner is not informed of all the facts relevant to an assessment of tax. Innocent evasion may lead to a reassessment. Fraudulent evasion may lead to a criminal prosecution as well as reassessment." Sawyer (1996, p. 486) observes this description of evasion being "dangerously close to avoidance, especially when an abusive tax position is included." In the decision judgement for *Challenge* (Privy Council, 1986,

[50] The Privy Council was replaced by the Supreme Court from January 2004.

paragraph [561]), Lord Templeman provided a clear statement on the difference between the two forms of evasion by stating:

> "*The distinction illustrates a key requirement of evasion, which is the necessary mental element or mens rea. A taxpayer must intend to avoid the payment of tax. If a taxpayer does not correctly meet their tax obligations because they have genuinely relied on information that has been provided which was incorrect, or in some other way they make an innocent mistake, then they are a party to innocent evasion*."

This statement operates as a solid foundation for distinguishing between the two forms of evasion by noting the importance between someone who deliberately cheats the tax system and someone who may have under-complied due to a lack of understanding of the tax law. In addition, Elliffe (2011, p. 454) states that "recklessness must not be confused with negligence" as recklessness requires taxpayer's knowledge or deliberate disregard towards the tax system, whereas, negligence does not require there to be presence of the 'knowledge' factor, thus difficult to establish it as tax evasion behaviour. An example of recklessness would be the case of *Zaheed* (Court of Appeal, 2010)[51] where the taxpayer was aware of his legal obligations but had failed to file GST and PAYE returns. Whereas, negligence could be found in the case of *Fepuleai* (Court of Appeal, 2008) where it was argued that the taxpayer had no 'knowledge' that he was "deliberately applying funds elsewhere to defeat his obligations of payment to the IRD [Inland Revenue Department]" (*Fepuleai* Court of Appeal, paragraph [14]).

The Interpretation Statement IS0062 (2006) on tax evasion issued by the Inland Revenue Department include a criteria (see Appendix A) that the Commissioner may consider before imposing a penalty, but these pre-set standards may also be acknowledging

[51] *Zaheed v R* [2010] CA650/2010 NZCA 573 (CA).

the fact that there may be different ‘degrees’ of seriousness under tax evasion scenarios. That is, the seriousness of tax evasion behaviours demonstrated by taxpayers under different circumstances. The following section looks at how the ‘degree’ of seriousness for tax evasion can be determined by examining the intention behind *why* and for how *long* the taxpayer had failed to meet their tax obligations. The amount of monetary value at issue under tax evasion scenarios vary between $36,000 by Ms. Emanuel (IRD, 2011d), and up to $35 million by 35 taxpayers (IRD, 2009d), therefore, it cannot be regarded as an influential factor for determining whether it is tax evasion. In addition, the ‘degree’ of evasion cannot be simply determined by looking at the *number* of charges involved in each case, as not all charges may carry the same ‘weighting’, thus, the focus for determining the seriousness of the issue should revolve around the characteristics outlined in Figure 1.

However, the *cause* and *effect* for evading tax liabilities is an important factor to consider as it was evident from the *Dempsey* (High Court, 2010) case where the taxpayer had failed to meet tax obligations because of a lack of understanding on what is expected of him and his business was given a more ‘lenient’ sentence than Mr. Smith, who had intentionally used the tax money to fund a lavishing lifestyle (*Smith* Court of Appeal, 2008). The District Court Judge for the *Dempsey* (2010) case stated in paragraph [12] that he had taken into account Mr. Dempsey’s “personal circumstances and the fact that this continued bad management and failure to comply [was not because of] greed or personal gain…” This intuitively implies that taxpayers who have obtained lower personal benefits may have been involved in a less serious form of evasion than taxpayers who evade for the dominant purpose of advancing their personal benefits.

Similar cases have been presented to the courts over the years where taxpayers have used the money owed or gained in an illegitimate manner to further enhance their personal living standards; that is, taxpayers who evade with ignorance. This is evident from Ms. Foot's (IRD, 2011e) case where she used undeclared income and fraudulent GST refunds to fund her overseas travel. Another taxpayer, Mr. Smith (IRD, 2009b), deliberately set up a separate copy of records for the Inland Revenue Department with the intent to escape certain tax payments. He then used the undeclared income "to fund a lifestyle that included overseas travel, purchasing expensive motor vehicles and importing pedigree dogs" (IRD, 2009b). Another example would be Mr. Hunter's (IRD, 2008b) case where he "deliberately avoided paying tax for frivolous personal reasons" and then used the unpaid amounts to spend on "holidays, doing things, having a good time … [and] wasted a lot of it" (IRD, 2008b).

These have been examples where the taxpayers have intentionally failed to meet their tax obligations, but instead, 'upgraded' their personal bank accounts, but with the result of being sentenced in a more severe manner than if they had not used the illegitimate money to support a lavishing lifestyle. Therefore, the 'reason' for the incomplete records obtained by the Inland Revenue authorities may to an extent, play an important role when determining the severity of the case, as not only is it important to draw a distinction between 'innocent' and 'fraudulent' evasion, but it is also important to assess how the taxpayers have 'exploited' the illegitimate tax money that has been either under-paid or over-claimed.

There also appears to be a common trend for tax evasion behaviours to be conducted out over a long period of time. It would be generally agreed that the longer the period that a taxpayer has been involved in acts of evasion, the larger the dollar amounts at issue, and thus, the easier it becomes for the court to determine that it is a case of serious fraudulent evasion.

For example, Mr. Ambler (IRD, 2011c) failed to file GST returns between July 2005 and March 2009, as well as failing to file income tax returns between 2006 and 2008. This is a case where a taxpayer has deliberately failed to meet their tax obligations over a prolonged period of time and it is undoubtedly a calculated attempt to disregard the tax laws. Mr. Phommasa (IRD, 2009c) was involved in an even longer period (seven years) of intentionally failing to file tax returns. Another example comes from Mr. Lucy's (IRD, 2011a) case where there were four years in question for personal income tax returns and five years for GST returns. These cases are a representation of how tax evasion usually span over a long period of time and hence, a characteristic that should be considered separately when assessing the seriousness of a particular case.

An example of a case that consider both the *scale* and *duration* of evasion would be the *James*' (Court of Appeal, 2010)[52] case where he had knowingly failed to file tax returns intending to evade the assessment or payment of tax over an eight year period. Judge Tuohy from the District Court stated that the taxpayer had used his tax payments to provide a "very comfortable lifestyle" for himself and his family and that some of the money was applied towards building an "expensive home" (*James* COA, paragraph [6]). As the taxpayer's "financial position did improve significantly with the benefit of evaded tax money" (*James* COA, paragraph [15]), it would be considered that this is a case where it involves a serious 'degree' of fraudulent evasion.

Despite its importance, the 'degree' of evasion should not interfere with the factors that have to be considered before agreeing that there are acts of evasion within a particular case. However, the acknowledgement on the distinction between the 'degree' of evasion has proven to be a determinant for the severity of the penalties imposed onto the taxpayers as the courts have a tendency to consider both the time-frame in question and whether the taxpayers

[52] *James v R* [2010] CA214/2010 NZCA 206 (CA).

have used the tax money for advancements in personal gains. Although these considerations do not assist in defining the concept of tax evasion itself, but they act as important issues that need to be considered for distinguishing between 'innocent' and 'fraudulent' evasion that was involved in the case and how the penalties would be imposed thereafter.

It is evident that case law takes an extra step than existing literature when determining how to interpret the concept of tax evasion. Tax evasion cases generally include two or more characteristics identified from Figure 2 before determining the 'degree' of evasion involved, or in other words, the seriousness of the case by aligning the facts of the case against certain principles (for example, the time period in question or how the tax money has been used by taxpayers) to ascertain how penalties should be imposed onto the taxpayers. Therefore, although not many case law judgments had defined the concept of tax evasion in a distinct sentence (other than applying the relevant sections from the legislation), it can still be agreed that case law provides another approach for understanding what tax evasion behaviour may incorporate by evaluating the characteristics associated with tax evasion. The factors from Figure 2 act as examples for understanding what the concept of tax evasion involves, and this would have been difficult to achieve if the concept was to be defined in a single sentence.

6.4 Response from Tax Practitioner A

The response received from tax practitioner A has been both interesting and helpful. First, tax practitioner A is "okay" with the definition of tax compliance provided by the Inland Revenue Department (IRD) as he believes that the definition is "clear" and it will be hard to "improve on IRD's one [definition]." It is clear from the response letter that the potential problems lie in the difficulties surrounding the concepts of tax planning and tax avoidance. They are two very closely related concepts and the blurriness between the two cannot be easily separated. Tax mitigation is believed to be a "redundant term from

Challenge used to justify avoidance behaviour" and this is consistent with what other studies have found (see Chapter 5.3.2.1 Tax mitigation). In addition, tax mitigation can be viewed as a behaviour that is adopted to "cover [acts of] tax avoidance".

In the tax compliance section of the questions, the way in which tax practitioner A would define the concepts are very similar to what existing literature has defined them as but interestingly, he has never heard of the term over-compliance. Despite this, he believes that over-compliance should be placed within the main branch of tax compliance, as opposed to non-compliance (that is, what this study has done).

As for the section on case law, tax practitioner A is happy with how the Judiciary implements particular approaches to determine the outcome of a particular case. He believes that the decision achieved in preceding cases act as a solid foundation for providing a "clear" understanding as to what is tax avoidance or tax evasion. The approaches and principles that have been adopted have been able to "stop" certain transactions from breaching the law and thus perceived to be effective, however, it is believed that there is still room for improvements that can be achieved for providing a clearer picture between what is acceptable and what is unacceptable at law.

7.0 Discussion and Contributions to Knowledge

7.1 Discussion

It is evident that the number of existing literature and case law over the years has significantly enhanced our understanding and knowledge in the area of behavioural tax compliance and non-compliance. However, due to the differences in which individual studies have been carried out and the uniqueness of the facts from each case law, inconsistencies between the definitions of tax compliance and non-compliance are still a major concern for researchers, governments and ultimately, taxpayers. The purpose of this study has been set out to examine how definitions for tax compliance, non-compliance, and their sub-categories have evolved (or remained fairly constant) over the years and the effect this has cast over the possibility of adopting 'universal' definitions for the relevant concepts from the perspective of taxpayers.

Being able to adopt comparable definitions between studies is crucial for future studies within this area. As stated earlier, 'universal' definitions for the concepts would mean better understanding and less confusion among the various studies conducted. As for case law, an explicit definition that goes beyond the statutory definition is presumed to be welcomed by those affected. However, this goal has proven to be hard to achieve. A number of factors can, and have, influenced how concepts are defined in existing literature and case law, and without a doubt, future cases within this area will also continue to encounter a number of factors that have the ability to influence how a particular study defines the concepts of tax compliance and non-compliance. Therefore, it is reasonable to conclude that although having 'universal' definitions for the concepts may be the desired outcome, but in reality, this goal cannot be achieved without producing further problems.

At best, definitions may become clearer and be more accommodating for the 'layers' and 'sub-categories' of tax compliance and non-compliance, but it will be of no surprise that variations of definitions continue to be applied in various studies in the future. A common weakness found in existing literature would be the lack of emphasis the author(s) have placed on what the concepts actually represent within their particular study. This is particularly evident from the number of studies that do not explicitly define the concepts of tax compliance and non-compliance (see Chapter 5.3.5 Studies That Do Not Define Tax Compliance and Non-Compliance). Therefore, if future researchers could define and explain clearly what the concepts mean and cover within their studies, then the level of misunderstanding and confusion could be reduced to a certain extent even if definitions cannot be made 'universal' (or consistent) across studies.

From a case law perspective, statutory definitions and precedent cases account for a significant weighting of how the concepts are recognized, thus, limiting the possibility of adopting unique definitions each time a tax avoidance/tax evasion case is heard. Although the existence of precedent cases implicitly set the standard of what tax avoidance/tax evasion entails, it is undeniable that there are potential benefits for the court and taxpayers in general. The approaches and principles taken by the Judiciary may be perceived as guidelines or boundaries as to what may be constituted as tax avoidance/tax evasion behaviours even though the facts of each case is unique in its own way. Therefore, creating a balance between the reliance on precedent cases and how the Judiciary act upon the issue at hand is important to understand the relevant concepts.

The number of studies conducted around the area of behavioural tax compliance and non-compliance has led to a number of different versions of definitions for the relevant concepts; therefore, it is an extremely difficult task to attribute 'universal' definitions for each of the concepts at issue. Nevertheless, a reasonable conclusion can be drawn that 'tax

compliance' involves taxpayers satisfying the applicable rules and regulations by paying the correct amount of taxes due at the right time. In addition, there is enough evidence to support the argument on the importance to distinguish between taxpayers who observe the 'letter' of the law, the 'spirit' of the law, or both, to determine the 'degree' or 'extent' of their compliance behaviour. Although it is again a subjective issue in ascertaining what is intended to mean by complying with the 'spirit' of the law, it may be reasonably justified that taxpayers who are 'committed' to meeting their tax obligations without enforcement activities by the tax authorities could fit into this particular category.

Another interpretation of taxpayers observing the 'spirit' and 'letter' of the law may be interpreted to some extent as either 'voluntary' or 'enforced' tax compliance. Both of these interpretations intend to incorporate contrasting attitudes towards tax compliance, however, it is important to note that they are not substitutes for the understanding of taxpayer behaviour, but rather, they should be perceived as different (or alternate) interpretations of how varying 'degrees' of tax compliance behaviour can be acknowledged. There is no presumed superior method as to which of these two approaches better-suit the understanding on the various 'degrees' of tax compliance, as the suitability of the approach taken should be reasonably justified within the study by the author(s).

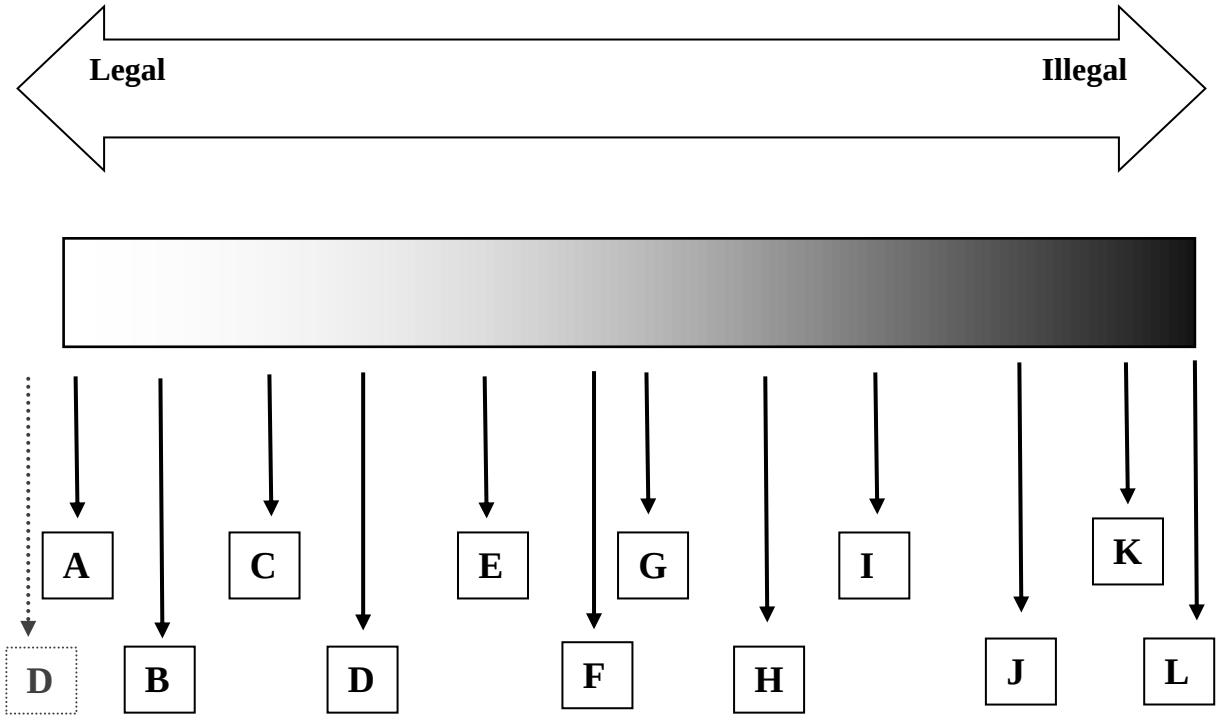
In the study by Wahl et al. (2010, p. 400), the definition for voluntary tax compliance is given as taxpayers contributing "their fair share to the common good, without hesitation." On the other hand, enforced tax compliance is recognized in situations where "taxpayers pay taxes because they are audited and fined, [but] might act strategically as soon as they find a way to evade taxes undetected" (Wahl et al., 2010, p. 400). It is plausible that there may be other forms of taxpayer behaviour within these two extremes, but they are not commonly recognized in literature and in practice.

In contrast to tax compliance, tax non-compliance is the opposite where it includes the main sub-categories of tax avoidance, tax evasion, and over compliance. Within non-compliance, behaviours such as: under-payment, under-reporting, and non-filing of tax obligations by the taxpayers are commonly detected (Slemrod, 2004). Other insignificant sub-categories within non-compliance was introduced in Chapter 5, but researchers have predominantly focused on the three main forms of non-compliance as the distinction between them are considered to be more productive from a research perspective. In addition, although there is clear indication of what is tax avoidance and tax evasion in practice, there remain the difficulties of being able to distinguish them clearly under different scenarios.

Furthermore, Goldsmith (1997, p. 11) states that the "borderline between the two concepts [tax avoidance and tax evasion] is very fine and rather than trying to distinguish between these two concepts, it is much more helpful and important to start from the basic idea that only tax evasion, as opposed to tax avoidance, is reproachable." This reflects the impracticality of attempting to distinguish further between the various sub-categories of non-compliance when the current state may be sufficient, given the limitations associated with attempting to further distinguish between the minor sub-categories of tax non-compliance.

The following figure (Figure 3) is improvised from the studies by Sawyer (1996) and Hughes (2009) to demonstrate the legality of how different behaviours between tax compliance and non-compliance could fit on a continuum. The left hand side of the continuum represents the 'good' side where it accounts for compliant taxpayer behaviours and the right hand side represents the 'bad' as it accounts for non-compliant behaviours. The white-to-black bar is inserted to represent how taxpayers comply according to whether they are complying with both the 'letter' and 'spirit' of the law (white), 'playing' around the loopholes of tax law (grey), or whether they are simply ignoring their tax obligations (black).

Figure 3: A Continuum Consisting of the Main Categories within the Parameters of Tax Compliance and Non-Compliance[53]



A	Full compliance with both the letter and spirit of the law
B	Compliance with the letter of the law
C	Acceptable tax minimization
D[54]	Over-compliance
E	Aggressive tax minimization
F	Creative compliance
G	Tax avoidance
H	Tax flight
I	Abusive tax position
J	Innocent tax evasion
K	Tax fraud
L	Fraudulent tax evasion

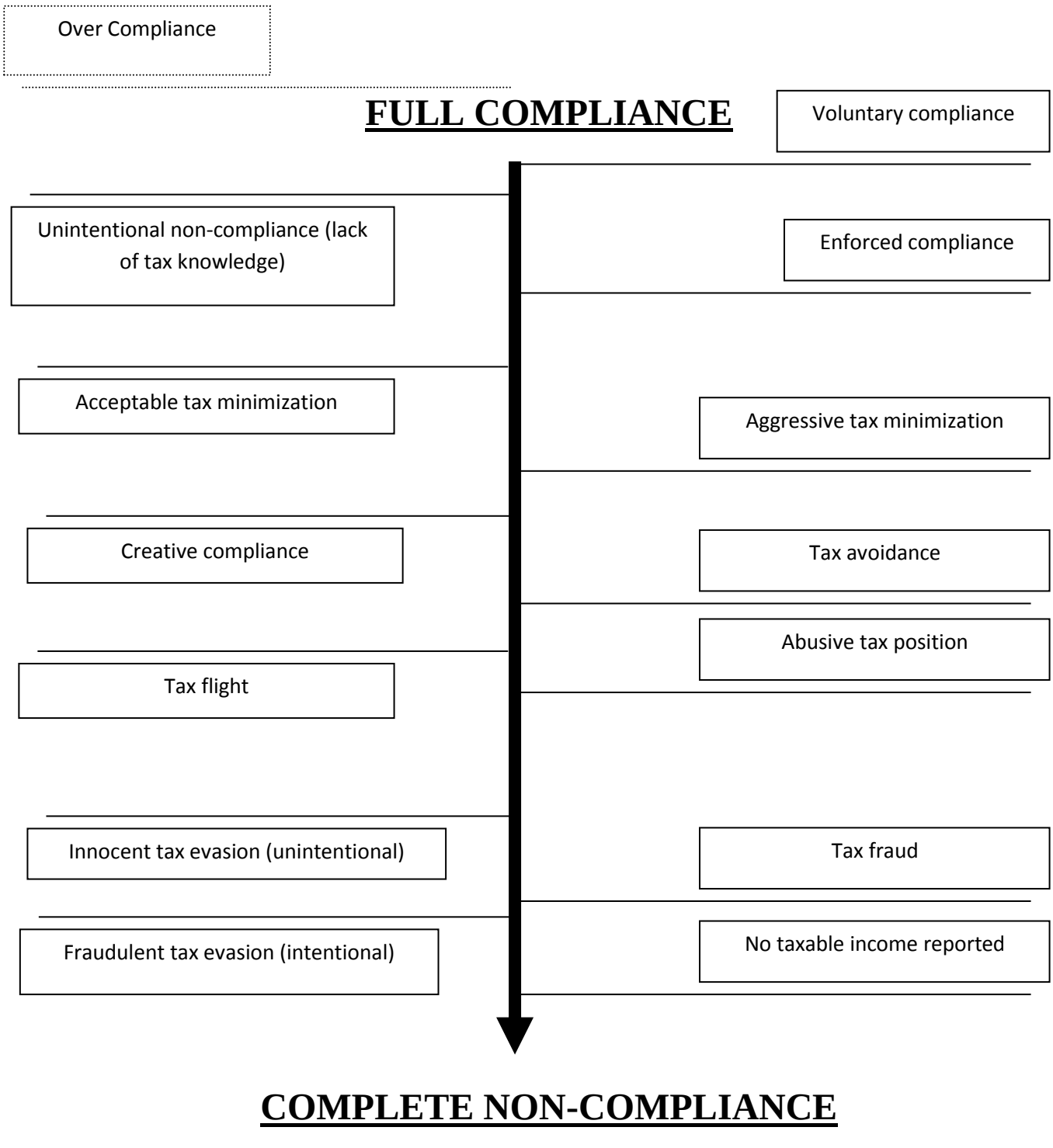
[53] This continuum may not necessarily consist of all the sub-categories of tax compliance and non-compliance; however, it is intended to provide an overall summary for the more prominent sub-categories within the two main branches.

[54] Over-compliance may also be perceived to be over-and-above full compliance with both the letter and spirit of the law (box A) as taxpayers have, for a number of reasons, met more tax obligations than what is legally required from them.

In addition to Figure 3, the following figure (Figure 4) is a representation for incorporating various sub-categories within tax compliance and non-compliance on a spectrum ranging from 'full compliance' to 'complete non-compliance'. It is adopted from the IRD's compliance model (see Figure 1). The following figure looks at the *attitudes* and *behaviours* of taxpayers when faced with their tax liabilities. Figure 4 shows a range of possible taxpayer behaviours where taxpayers could either comply willingly (the top of the spectrum at 'full compliance') or they could choose to not declare/pay any taxes at all (the bottom of the spectrum at 'complete non-compliance'). However, it is important to note that this figure does not look at the *motive* or *intent* as to why taxpayers choose to comply or not comply with their tax obligations. Furthermore, it is also important to consider that there may be various methods for placing the various behaviours on the spectrum.

In addition to the link Figure 4 shares with the IRD's compliance model, the following figure also takes into account the 'over-compliant' taxpayers who have, for various reasons, missed out on claiming their legitimate refunds (Sung, 2009). The group of 'over-compliant' taxpayers are placed separately above the spectrum as they are perceived as a group that have met over-and-beyond what was expected from them from a compliance perspective (see Chapter 5.3.4.).

Figure 4: A Behavioural Compliance Spectrum Consisting of the Main Categories within the Parameters of Tax Compliance and Non-Compliance[55]



[55] This spectrum may not necessarily consist of all the sub-categories of tax compliance and non-compliance; however, it is intended to provide an overall summary for the more prominent sub-categories within the two main branches. In addition, it is important to note that this continuum is based upon the *behaviour* of taxpayers, rather than motive or intent. Note that some taxpayers and tax advisors may perceive the line of "full compliance" to fall nearer to the level of "acceptable tax minimization" (or even lower).

7.2 Contributions to Knowledge

In general, this study has placed emphasis on researching a fairly new area concerning behavioural tax compliance and non-compliance literature, but at the same time, it replicates ideas from existing literature on the understanding of the relevant concepts. It is evident that existing literature have not been able to settle on a common definition, nor improve on the clarity for the concepts of tax compliance, non-compliance and their sub-categories across various studies. The inconsistencies in the definitions are particularly evident in case law where the views of the Judiciary have the potential to influence the decision reached in courts. In addition, external factors (such as: the state of the economy and the government) also have an impact on how the concepts are comprehended under different timeframes and scenarios. Therefore, the objectives introduced in the beginning form the basis for this study's contribution to knowledge.

For this study, the most important contribution to literature is its effort to describe how various definitions for the concepts of tax compliance and non-compliance have been applied over the years in both existing literature and case law. The number of existing literature gathered for this study provides a solid foundation for interested parties as to how the relevant concepts have been defined or applied in literature over the years. In addition, the tables that have been used to outline the definitions gathered for this study in Chapter 5 enhanced aspects of clarity and comparability for future studies within this area. As for case law, the aim to conduct a preliminary study on how New Zealand Judiciary applies the definitions of tax avoidance and tax evasion was also achieved through the examination of recent tax avoidance and tax evasion cases. In addition to the influence of preceding cases, the analysis of how the approaches and principles that have been applied in recent case law enhances our understanding as to what sort of taxpayer actions may amount to tax avoidance

or tax evasion. Although the facts of each case is different, this study's analysis on recent case law acts as a guideline for taxpayers who are in a similar situation in the future, and may also act as a 'warning' for taxpayers who may be thinking of 'dodging' around the grey areas of tax law.

As well as looking at the various definitions for the concepts of tax compliance and non-compliance, this study has also examined the benefits and costs of the current situation with the possibility of having 'universal' definitions for each of the key concepts. Regardless of the preferred outcome, it is important to acknowledge that it may be impractical in some situations to 'force' a pre-determined definition to the concept. Although having a 'universal' definition could reduce the issues of confusion and misunderstanding, factors such as the type, and nature of study, the time of publication, and the scope of study conducted, can all influence the 'version' or 'comprehensiveness' of the definition adopted. As well as the factors associated directly with the study itself, external factors such as the government's rules and policies, and the state of a country's economy and well-being may all contribute to the impracticability of only having a 'universal' definition for the concepts. Therefore, having various factors that could affect the way in which the concepts of tax compliance and non-compliance are defined and applied in studies, there is solid ground for justifying that the use of 'different' or 'improvised' definitions in particular circumstances may be considered more sensible and thus, reflective of the study carried out after considering the possible influential factors.

The response from the tax practitioner was useful as it provided information from a different perspective. Having a view from a practical field has certainly provided a different angle on the issues surrounding tax compliance and non-compliance. The tax practitioner's view and comments on the concepts and the topic overall not only confirms ideas that have

been gathered from existing literature and case law, but it also added another perspective to the topic where it could not have been possible to extract from the internet or the libraries. Therefore, this study has combined research results from both theory and practice (via case law) to produce a wider perspective on the issues and problems surrounding the concepts of tax compliance and non-compliance.

8.0 Conclusions, Limitations and Future Research

8.1 Conclusions

The understanding on the concepts of tax compliance, non-compliance, and their sub-categories should remain the focus of research for future studies. This can be achieved through a better understanding of the concepts by reducing inconsistencies and confusion between different studies. There is still a considerable scope of research to be conducted around this area as the external factors associated with *how* the definitions are established may change over time. It is important to bear in mind that a number of existing studies *describe* the concepts, rather than providing an explicit definition, and although it facilitates our understanding of the concepts, descriptions or examples should not be confused with an actual definition.

Furthermore, the priority of future studies should be to establish 'universal' (or consistent) definitions for the concepts of tax compliance and non-compliance, but researchers should be complacent with what has been achieved in literature to date until new or improvised methods have been implemented to enhance the approaches taken to define the relevant concepts. It is also important to consider the influence external factors may have on how the concepts are defined as this will create a clearer picture as to what considerations are necessary when coming up with a definition for the concepts of tax compliance and non-compliance.

There is probably not as much room for improvement in case law as there are certain procedures that have to be followed by the Judiciary, such as, the application and consideration of statutory legislation and decisions from preceding cases of a similar nature. Despite this, there should still be an emphasis for the Judiciary to implement certain definitions over-and-beyond what has been set out in the legislation to further enhance our understanding of what tax avoidance and tax evasion incorporates. The diagram (see Appendix C) set out in the Appendix of the Interpretation Statement on tax avoidance issued by the IRD (2011f) is a comprehensive overview for establishing whether a particular case is tax avoidance. However, it is questionable as to whether the diagram is sufficient for capturing this complicated problem of tax avoidance as there are too many uncontrollable factors. Nevertheless, the diagram is a useful guide for taxpayers and associated parties to determine at an initial stage as to whether certain behaviour is tax avoidance. It would therefore be beneficial if a similar diagram could be prepared for tax evasion. However, the diagrams are not intended to 'encourage' certain behaviours, but they will be of use for associated parties to gain a better understanding of the situation so that they do not face unintended consequences.

Better or more comprehensive definitions for the concepts of tax compliance and non-compliance also have the potential to reduce the widened tax gaps experienced by governments over the years. Not only is the establishment of comprehensive definitions important for taxpayers and governments, but the perceived fairness of the tax systems are also important.

This is supported by Book's (2003, p. 4) remark where he states that even broad categories like intentional and unintentional compliance are insufficient to understand fully the dynamics of non-compliance," and so, it is agreeable that taxpayers would be "more inclined to comply with the law if the exchange between the laid tax and the performed

government services are found to be equitable" (Torgler, 2007, p. 74). In addition, Wenzel (2002, p. 630) stresses on the importance of having a 'fairer' tax system because, "although some people may find some unlawful acts of evasion illegitimate according to their concept of right and wrong, they may regard respective acts of evasion, even though unlawful, as morally justified [if they perceive the tax system to be unfair]."

In conclusion, since 'universal' definitions cannot be achieved given the current state of literature and case law, the direction of focus for studies should be placed upon the approaches taken to define the concepts of tax compliance and non-compliance. As for the sub-categories within the main branches of tax compliance and non-compliance, the acknowledgement of their existence should be emphasised in hierarchy order in terms of their dominant existence as it is both unhelpful and impractical to dwell into the minute details of those sub-categories that are not important in literature or case law.

8.2 Limitations

Due to the scope of this study, it was necessary to place some pre-determined boundaries to ensure that this study could be completed within the timeframe and resources available. Both existing literature and case law from New Zealand have been included as sources of data information, and throughout the data collection process, a number of limitations are evident and unavoidable for this study

First, in order to concentrate on the behavioural fiscal psychology domain of tax compliance and non-compliance, literature that is of an economic or finance-based nature has not been considered in great detail. It is likely that some valuable information may have been missed out on because of the exclusion of those studies, but because of the lack of skills and knowledge within the area, it was considered appropriate to exclude those studies to a significant extent to reduce the risk of derailing from the objectives set out for this study.

Nevertheless, a few economics or finance-based studies have been cited as those studies did not require a high level of mathematical-related background to understand and interpret the results from those studies.

As well as the exclusion of economics and finance-based studies, all non-English texts have also been excluded. This was a necessary step to take in order to avoid translation issues that may arise if the results from foreign-language studies are included. As well as being able to avoid inconsistencies from translating a study, the exclusion of non-English texts has allowed for clear boundaries to be in place in order to ensure that the scope of this study is of a manageable size, given the time and resource constraints.

Second, although this research has focused predominantly on the behavioural fiscal psychology domain of tax compliance and non-compliance, it was still a challenge to include all existing literature into this study. However, this study has attempted to include as many references as possible during the data collection process by utilizing various sources of information. Therefore, it may be possible that the definitions included and discussed within this study may not be a full representation of a conclusive set of all potential definitions in the realm of existing literature on behavioural tax compliance and non-compliance. Nevertheless, it is believed that this study has captured the essence of the main characteristics for the concepts of tax compliance and non-compliance, as well as having examined the more commonly known ‘layers’ and the ‘sub-categories’ that are present under those two main branches.

In addition, case law outside New Zealand’s jurisdiction was also excluded because different countries operate under different jurisdictions, and this would mean that the focus of this study would be too widespread. By limiting the search to only New Zealand case law, this has allowed for a closer examination on how the courts handle the various forms of non-

compliance behaviours. Once again, not all tax avoidance and tax evasion cases have been cited, but the cases studied act as a representation as to how the Judiciary perceive those behaviours through the adoption of various approaches and principles to determine the form (and extent) of non-compliance activity. Furthermore, by focusing primarily on recent cases from New Zealand, this means that the laws applicable within the cases are current (to an extent) and that the discussions made between the cases would be more comparable. It is hoped that by opting for a more detailed analysis on the selected cases would allow for a more thorough understanding on the kind of definitions adopted or interpreted in case law scenarios.

Third, the gathering of opinions from taxpayers has not been included. This study has not conducted interviews or distributed surveys to taxpayers in general as this study had intended to only look at the issues from the perspective of existing literature and case law. There are two main reasons for not incorporating opinions from taxpayers. The first reason is because of the sensitivity and complexity of the topic studied, where it involves a high level of abstraction and technical terms that may be considered to be too difficult for taxpayers to comprehend (Hofmann et al., 2008). It is believed that if a taxpayer's ability to complete the survey/interview would be impaired as a result of the technical aspects and terms associated with the topic, then it is highly likely that this will have an impact on the completeness of the response, and therefore, the results for this study. In addition, by including the opinions of taxpayers into the study, there will be too many behavioural variables (as seen from the study conducted by Jackson and Milliron, 1986) that cannot be controlled nor limited, and thus, creating difficulties to compare between participants' responses. Furthermore, due to the sensitive nature of this study, the essential factors for a valid survey or interview would be difficult to achieve, as outlined by Jackson and Milliron (1986). This is because some taxpayers may not be willing to disclose confidential and sensitive information on their

attitudes and behaviours on the area of tax compliance and non-compliance. The three essentials are, namely: the ability to obtain a representative sample, to have an adequate response rate, and, getting honest responses (Jackson and Milliron, 1986). Due to resource, time, and budgetary constraints, it would not be likely to have a nation-wide pool of participants, nor would it be likely to receive an adequate response rate, therefore, leading to the possibility of biased results (Richardson and Sawyer, 2001).

Fourth, the definitions for the concepts of tax compliance, non-compliance, and their sub-categories have been ordered in chronological order according to publication dates. This method of ordering was selected as it provides an easier approach to look back at how the definitions for the concepts have evolved (or remained constant) over time. Although the ordering method selected may not be considered the best approach to order the various definitions, but it is believed that this approach provides a clearer picture for readers to see how the concepts have (or have not) changed over the years and across the different domains of study. In addition to the possible weakness as a result of how the definitions have been ordered, there may also be some disagreement as to the choice of case law that has been gathered for this study.

Due to the widespread number of cases from New Zealand since 2008, it would be impossible to cite all tax avoidance/tax evasion related cases given the time and resource available for this study. As a result, some readers may disagree on the suitability of the cases selected; however, it is believed that this study has captured the essence of the approaches and principles taken by the Judiciary between the various tax avoidance/tax evasion cases, and how the concepts have been defined under various circumstances. In addition, it is in the author's view that various landmark tax avoidance/tax evasion cases have been examined and the discussions on those cases are considered adequate for the purposes of this study.

8.3 Future Research

The following list comprises of potential areas for future research in the area of behavioural tax compliance and non-compliance. This is not an exhaustive list as the scope of research within this area of research is both wide-ranging and diversified. Nevertheless, the list is intended to act as a guideline for researchers who may be interested in this area concerning behavioural tax compliance and non-compliance. The possible areas of future research outlined below are based upon the objectives from this study where it focuses on both the implicit and explicit approaches taken to define the concepts of tax compliance, non-compliance, and their relevant sub-categories.

First, future studies could easily expand on the scope of research conducted for this study in the form of introducing the presence of taxpayers. Their knowledge and understanding of the tax law is likely to be at a different level from tax practitioners and the government due to the complexity of the topic and, therefore, introducing a different perspective as to how the concepts of tax compliance and non-compliance can be defined. This approach will further enhance our understanding on the definitions for the concepts of tax compliance and non-compliance. This may either create an advantage if it could facilitate the process of attributing a 'universal' definition for the concepts or prove to be a disadvantage if it further complicates the problem in an unhelpful manner if additional 'extractions' associated with the relevant concepts are introduced. A 'universal' definition for the concepts may be established by aggregating the similarities between the various definitions, while assuming that the taxpayers do not have too many 'unexpected' understandings on the concepts that will have to be considered as 'outliers'.

By introducing further players into a study, other sub-categories of tax compliance and non-compliance may also be 'extracted' due to other factors that have to be taken into consideration, such as the Code of Ethics or specific government rules and policies that taxpayers have to abide to. The possibility of having more sub-categories is not intended to complicate the problem, but rather, to act as a helpful method for grouping the various forms of tax compliance and non-compliance behaviours into distinct categories to reduce unnecessary confusions and misunderstandings. This may be achieved by comparing the similarities between the more insignificant sub-categories and organize them into general groups where they may be better understood and accepted by taxpayers and associated parties.

The inclusion of taxpayers would involve the distribution of surveys and/or questionnaires in order to collect their perspectives on how they would perceive or define the concepts of tax compliance and non-compliance. Since this would become an experimental research, potential researchers would need to control for various variables to limit the scope of research to a manageable size and the possibility of experiencing a low response rate due to the complicated nature of the topic.

Second, if time and resource permits, future research could examine case law from a wider selection of countries. This study has focused predominantly on the cases that have originated from New Zealand, but undoubtedly, there is a great deal of research value if future studies could conduct a search on case law from an international perspective. As there are numerous tax avoidance and tax evasion related-cases worldwide, it would be necessary to set clear boundaries on the scope of research, and one possible approach would be to study selected case law that have originated from one of the Commonwealth countries. Another possible approach could be to select a few countries and examine how the approaches and principles applied by the Judiciary have changed (or not changed) over the years, and

whether the changes are consistent with the changes in government laws and regulations. Another possibility could be to conduct a comparative analysis by selecting one or two countries and examine how the approaches and principles adopted by the Judiciaries from those countries differ from New Zealand's judiciary.

Regardless of the countries have been selected for study, certain constraints are important to have been considered. For example, limitations may include language barriers/inconsistencies between legislations/tax systems and access of relevant information when studying case law from a multi-national perspective. By incorporating a number of case law from a variety of countries would allow for a more detailed discussion on the approaches and principles taken by the Judiciary and how they have applied them under different circumstances. However, care must also be taken when comparing results between countries as each country has its own independent tax background where it may lead to discrepancies as to how the concepts of tax compliance and non-compliance are understood within each case law scenario.

Third, it may be interesting to examine the topic of behavioural tax compliance and non-compliance from a tax administration perspective. That is, examine methods that could be adopted by the government or revenue agencies to educate its taxpayers in order to increase the tax compliance rate, and at the same time, combat the problem of tax non-compliance. This potential area for future research does not focus on how the concepts of tax compliance and non-compliance should be defined, but rather, it examines how the compliance rate can be 'boosted' by the government. As not all taxpayers will respond to the same method of education, future research could also examine different 'tactics' for different groups of taxpayers. The increase in compliance rate will have a flow-on effect of seeing less non-compliant taxpayers and thus, the government may not have to consistently dwell into the

many sub-categories within non-compliance.[56] As well as the increase in compliance rate because of better education, taxpayers would also be considered to be more socially responsible as they would have met their fiscal obligations to a higher standard (Devos, 2004).

Last, there is still much to learn about how behavioural factors, such as age and gender, can influence approaches taken to define the concepts of tax compliance and non-compliance. In the past, researchers have either focused on how behavioural factors can influence *why* people comply, or, placed emphasis on *how* the concepts are defined, but never really combined the two together within one study. Thus, the integration of the behavioural aspects and the approaches taken to define the concepts may not only enable future researchers to identify existing flaws in the current definitions, but also help future studies to determine better-suited definitions for the concepts of tax compliance and non-compliance.

In sum, there are a number of potential areas for future research, either expanding the scope of research from what this study has achieved (in terms of the analysis on the definitions for the concepts of behavioural tax compliance and non-compliance), or limiting the scope of research to allow for the study to 'dig' deeper within a defined area (for example: focusing on behavioural tax compliance and/or non-compliance). Either method would undoubtedly surprise the researcher on the unexplored areas within the topic of behavioural tax compliance and non-compliance.

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[56] It has sometimes been considered unnecessary for the sub-categories within tax non-compliance to be extracted as this has been described 'unhelpful'. For example, the Judiciary from *Challenge* thought it was unnecessary to distinguish between tax mitigation and tax avoidance.

9.0 References

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10.0 Appendices

10.1 Appendix A- Paragraph 4.12 from Interpretation Statement 0062 (IS0062)

…

4.12 In determining whether to impose a shortfall penalty for evasion the Commissioner will consider a number of criteria including:

• Whether the taxpayer has been previously prosecuted and/or been subject to shortfall penalties for evasion;

• The reason given by the taxpayer for his/her behaviour;

• The degree of culpability of the taxpayer;

• The likelihood of future compliance;

• The degree of cooperation received from the taxpayer;

• The effect on promoting voluntary compliance; and

• The duty to protect the integrity of the tax system.

…

10.2 Appendix B- Excerpts of Section YA 1 from the Income Tax Act 2007

YA 1 DEFINITIONS

…

arrangement means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect

…

tax avoidance includes—

(a) directly or indirectly altering the incidence of any income tax:

(b) directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:

(c) directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax

tax avoidance arrangement means an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—

(a) has tax avoidance as its purpose or effect; or

(b) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental

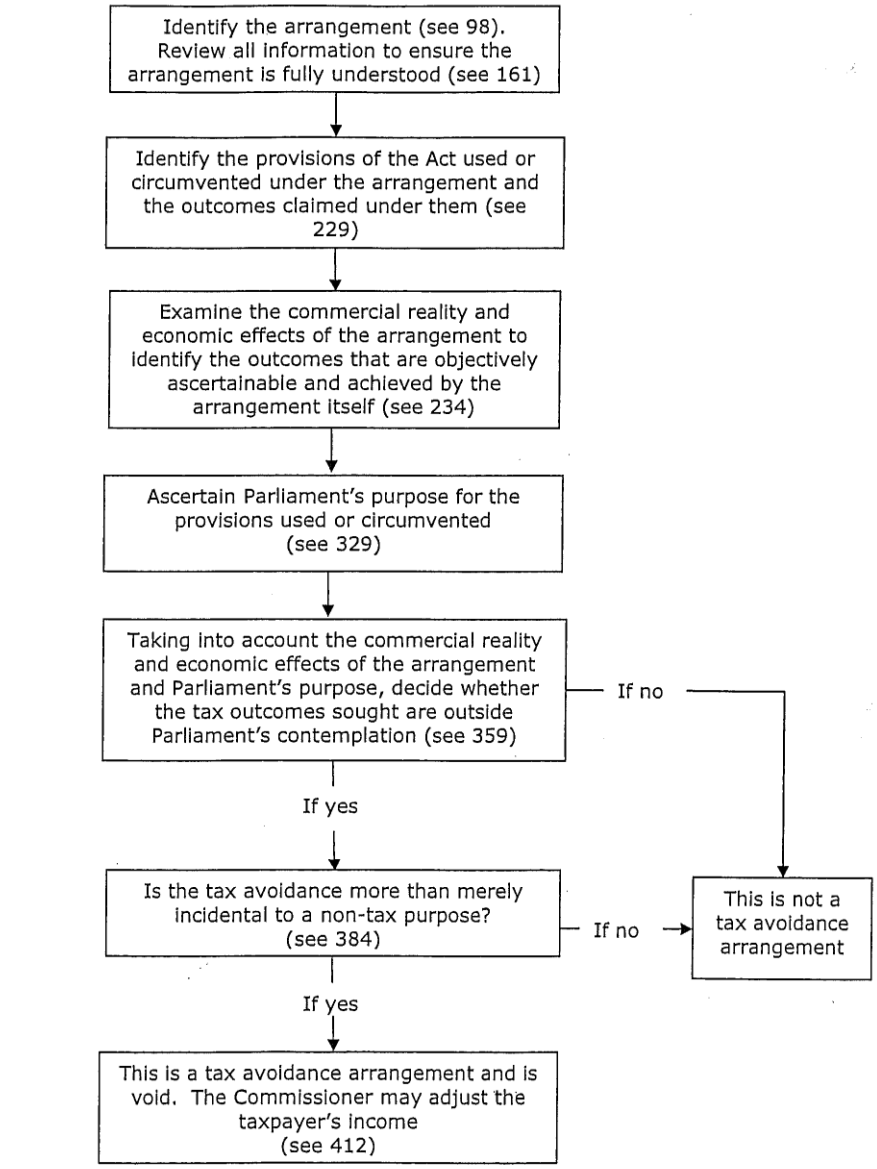
…

10.3- Appendix C- Diagram from Draft Interpretation Statement (IS) on Tax Avoidance

EXPOSURE DRAFT—FOR COMMENT AND DISCUSSION ONLY

SEQUENCE OF ANALYSIS IN COMING TO A VIEW ON WHETHER SECTION BG 1 APPLIES TO AN ARRANGEMENT

The following diagram illustrates in simplified form the steps to take in analysing whether section BG 1 applies to an arrangement.



10.4 Appendix D- Approval Letter from the Human Ethics Committee

UNIVERSITY OF CANTERBURY
Te Whare Wānanga o Waitaha
CHRISTCHURCH NEW ZEALAND

HUMAN ETHICS COMMITTEE

Secretary, Lynda Griffioen
Email: human-ethics@canterbury.ac.nz

Ref: HEC 2011/105/LR

9 January 2012

Rebecca Wu
Department of Accounting & Information Systems
UNIVERSITY OF CANTERBURY

Dear Rebecca

Thank you for forwarding to the Human Ethics Committee a copy of the low risk application you have recently made for your research proposal "A study of tax compliance and tax non-compliance in the context of the current literature and case law: a New Zealand perspective".

I am pleased to advise that this application has been reviewed and I confirm support of the Department's approval for this project.

With best wishes for your project.

Yours sincerely

Michael Grimshaw
Chair
University of Canterbury Human Ethics Committee

10.5 Appendix E- Letters to Tax Practitioners and Response from Tax Practitioner A

UNIVERSITY OF CANTERBURY
Te Whare Wānanga o Waitaha
CHRISTCHURCH NEW ZEALAND

9 January 2012

A Study of Tax Compliance and Tax Non-Compliance in the Context of the Current Literature and Case Law: A New Zealand Perspective

Information Sheet for Letter Recipients (Tax Practitioners)

I am a postgraduate student from the College of Business and Economics at the University of Canterbury. My research area is predominantly around the area of behavioural tax compliance where I am currently exploring *how* and *why* the definitions for the concepts of tax compliance, non-compliance and their relevant sub-categories (for example: tax avoidance, tax evasion and ultimately, over-compliance) differ in the literature. In addition, I am currently looking at the feasibility of attributing a 'universal' definition to each of the concepts, as well as exploring the issues and problems that may be encountered if the definitions are made more consistent, as well as exploring the current issues associated with the various forms of definitions for the concepts.

I would like to invite you to participate in my study. If you agree, you will be required to respond to a letter containing several questions on the topic of behavioural tax compliance. However, you will have the option of answering the questions verbally where I could conduct a brief interview in person. The purpose of this is to obtain your views and comments on the issues concerned with the study, as well as other potential issues that have not yet been focused on. Responding to the questions from the letter should take approximately 30-45 minutes. Should an interview be conducted, you will have the right to decline any form of recording that you are uncomfortable with. If the interview was able to be recorded, you will be able to review a copy of the transcript. All participants will be sent a copy of the final study via email.

Please be assured that participation in this study is voluntary. If you choose to participate, you will have the right to withdraw from the study at any time without penalty. If you withdraw, I will remove any information relating to you as far as is practically achievable.

I will take extreme care to ensure that the data gathered for this study remains confidential, where the data will be securely stored during my year of study. I will also take particular care to ensure your anonymity in publications of the findings. After this period, the data will be securely stored in password protected facilities and locked storage at the University of Canterbury for five years before it is destroyed. Please note that a Master's thesis is a public document that can be accessed via the UC's library database.

If you have any questions or concerns about the study at any stage, please contact me. This study has received ethical approval from the University of Canterbury Educational Research Human Ethics Committee, and if you have any complaints, please address them to The Chair, Human Ethics Committee, University of Canterbury, Private Bag 4800, Christchurch (human-ethics@canterbury.ac.nz).

If you agree to participate in this study, please complete and return the attached consent form via email as soon as practical.

I am looking forward to hearing back from you and thank you in advance for your contributions.

Yours sincerely,

Rebecca Wu

Email: rcw46@uclive.ac.nz
Phone: 0210382780

9 January 2012

UNIVERSITY OF CANTERBURY
Te Whare Wānanga o Waitaha
CHRISTCHURCH NEW ZEALAND

A Study of Tax Compliance and Tax Non-Compliance in the Context of the Current Literature and Case Law: A New Zealand Perspective

Consent Form for Letter Recipients (Tax Practitioners)

I have been given a full explanation of this project and have been given an opportunity to ask any questions.

I understand what will be required of me if I agree to take part in this project.

I understand that my participation is voluntary and that I may withdraw at any stage without penalty.

I understand that any information or opinions I provide will be kept confidential to the researcher and that any published or reported results will not identify me. In addition, if an interview is to be conducted under my approval, I understand that I have the right to decline the recording of the interview.

I understand that all data collected for this study will be kept in locked and secure facilities at the University of Canterbury and will be destroyed after five years. However, I am aware that a Master thesis is a public document that be accessed through the University of Canterbury's library database.

I understand that I will receive a report on the findings of this study. I have provided my email details below for this.

I understand that if I require further information, I can contact the researcher, Rebecca Wu. If I have any complaints, I can contact the researcher's supervisors, Prof. Adrian Sawyer or Mr. Alistair Hodson, or the Chair of the University of Canterbury Human Ethics Committee.

By providing my details below, I agree to participate in this research project.

Name: _____

Email address: _____

Date: _____

Please attach this completed consent form via post with the response letter.

College of Business and Economics

Department of Accounting and Information Systems

Tel: +64 3 364 2613, Fax: + 64 3 364 2727

UNIVERSITY OF CANTERBURY
Te Whare Wānanga o Waitaha
CHRISTCHURCH NEW ZEALAND

16 January 2012

Dear XXX,

I am currently studying towards a Master of Commerce degree at the University of Canterbury, Christchurch, New Zealand. My thesis is on the topic of behavioural tax compliance and non-compliance primarily from the perspective of taxpayers, but also from a tax practitioner's perspective. The thesis sets out to examine *how* and *why* the definitions for the concepts of tax compliance and non-compliance differ in existing studies in the literature, as well as in case law (from both Australia and New Zealand in order to draw possible comparisons between the two jurisdictions).

As well as looking at the various definitions available within existing studies and case law, I will also look at the possibility of allocating a 'universal' definition to each of the concepts of tax compliance and non-compliance to enhance the comparability and understandability of future studies in this area. Lastly, this study is set out to evaluate the potential problems that may exist as a result of higher uniformity in the definitions, as well as considering any problems that may arise if definitions cannot be made more consistent between future studies of behavioural tax compliance and non-compliance.

Therefore, the intention of this letter is to collect your views and opinions on this matter, where it would be greatly appreciated if you could answer the questions that you feel comfortable with (please see the accompanying pages). It is up to your discretion as to whether you would prefer to post/email the responses, which may be more convenient (time-wise), or whether you would prefer an interview to be conducted. I understand the sensitivity of the topic where you may not be permitted to disclose confidential information; therefore, I will keep your name anonymous, where your identity will remain confidential in the final report.

Should you have any further questions, you are welcome to contact my primary supervisor, Prof. Adrian Sawyer, on (03) 3642617.

I look forward to hearing from you soon and thank you for your time and cooperation.

Yours sincerely,

Rebecca Wu

P: (+64) 210382780
E-mail: rcw46@uclive.ac.nz

The questions are organized into categories where there are four to six questions within each category to get a good understanding of the area in concern. There are spaces for you to write/type your responses and should you need more space, there are extra pages at the end of the questions.

General

1. How would you define (or provide descriptions for) the following concepts:
   - i. Tax compliance – meeting your statutory obligations in terms of ~~p~~ filing and payment.
   - ii. Enforced compliance ↳ not heard this before.
   - iii. Voluntary compliance : voluntarily meeting your statutory obligations re filing & payment
   - iv. Tax planning : ↳ euphemism for avoiding tax.
   - v. Tax mitigation : redundant term from challenge case ~~used~~ but often used to justify avoidance behaviour
   - vi. Tax non-compliance ↳ not filing & not paying
   - vii. Tax avoidance : structuring situations so as to either get deductions where there is no corresponding economic cost or to get positions where no tax is ~~returned~~ earned legally but economically one still enjoys the income.
   - viii. Tax evasion ↳ not telling IRD the correct facts.
   - ix. Tax fraud = ditto.
   - x. Intentional non-compliance : ~~same~~ soft form of evasion
   - xi. Unintentional non-compliance : ~~same~~ = mistake
   - xii. Abusive tax position : avoiding tax being reditiously agressive.
   - xiii. Over-compliance : ? Never heard of it.

This is legal all the law non acceptable behaviours are covered.

2. On a spectrum of acceptable/unacceptable behaviour, how would you place the above terms? And on a separate spectrum of legal/illegal behaviour, would the placement of the above terms differ? Why or why not?

spectrum = unacceptable { Tax evasion, Tax fraud, Tax avoidance, Intentional non compliance. } Tax non compliance

= acceptable = { tax compliance, over compliance, tax mitigation, tax planning, unintentional non compliance

3. A lack of clarity between the definitions of tax compliance and non-compliance has caused both intentional and unintentional forms of non-compliance. What potential problems do you think will arise if a 'universal' definition is attributed to the concepts of tax compliance, non-compliance, and their relevant sub-categories? In addition, what sort of problems do you think are currently being experienced by governments and taxpayers due to a lack of consistency between the definitions?

I am not sure there are any problems caused by lack of clarity in definitions. lawyers like using phrases like tax planning & tax mitigation to cover what is really tax avoidance.

4. To an extent, the definitions that are adopted in existing literature differs from the definitions adopted under case law scenarios, would you expect the current situation to improve in the short run/long run?

I am not sure if I agree with the starting premise behind the question.

5. What is perceived to be tax compliance and non-compliance behaviour by a taxpayer may be different from the CIR's perspective, what would be an ideal solution to this problem (if any)? Also, what would you believe to be the cause of this?

Compliance is clear & defined already. It means filing on time & declaring the correct income and paying on time.

6. The fine line between tax planning and tax avoidance has always been a dilemma for both the government and taxpayers, what sort of changes do you propose can be made in order to improve this?

It is difficult to improve on this area. Taxpayers always claim they want certainty but that is really certainty to know how much can be avoided without challenge by IRD. The whole culture needs changing so that people just pay what is due or make clear choices between alternatives set out in the legislation.

Tax Compliance

1. Would you consider the current definitions of tax compliance (for example, the definitions adopted by the IRS and the IRD) to be adequate when taking into account the difference between voluntary and enforced compliance? Why or why not?
   - The IRS defines tax compliance as "when the taxpayer files all required tax returns at the proper time and that the returns accurately report tax in accordance with the Inland Revenue Code, regulations and court decisions applicable at the time the return is filed."
   - The IRD views tax compliance as when
     i. Everyone pays and receives the right amount
     ii. We (the IRD) receive the right information at the right time
     iii. Everyone files and pays on time
     iv. We (the IRD) provide confidence and certainty to our customers

Yes. IRD's one is better. I can't see how one can improve on IRD's one.

2. The issue of a taxpayer complying with the 'letter/spirit' of the law has been raised in a number of existing studies, would you consider it necessary to distinguish between the two? Why or why not?

Yes. One way of doing that would be to have specific assumption provisions, eg for deductions there could be a section that says Parliament assumes that unless explicitly excluded all expenses on which deductions are taken will have the following features, (1) have a real economic cost (which would be defined) (2) would occur at market price (3) would be in the course of a business etc.

3. It is a challenge for legislators to objectively identify whether a taxpayer has complied with both the 'letter' and 'spirit' of the law. What sort of measures could be devised by the legislators and the concerned parties to improve on this (or whether it is achievable at all)? The situation set out above would help.

4. Would you agree that if a taxpayer has complied voluntarily, then they would have met the letter and spirit of the law? Alternatively, if a taxpayer is enforced to comply, then is it likely that they may have failed to comply with both the letter and spirit of the law? Why or why not?

No. voluntary compliance may be met in terms of filing, accuracy (in terms of black letter provisions) and payment but still constitute avoidance = see Alesco case.

5. James and Alley (2002) believe the concept of 'tax compliance' cannot be defined in a single sentence (for example, the approach taken by the IRS) and in order to fully capture the possible 'degrees' of compliance, there needs to be a continuum of definitions for 'tax compliance', do you agree/disagree with this statement? Why?

The IRD definition is okay can't see problem with it.

Tax Non-Compliance

1. Some studies have raised the concern that some taxpayers view 'tax evasion' as only a little more serious sort of crime when compared to that of stealing a bike (Song and Yarbrough, 1978), what is your comment regarding this situation?

No it should be viewed ~~as~~ in the same way as corporate fraud. Seriously. It is stealing from the community.

2. Due to the complex nature of the tax system, some researchers believe it is unnecessary to place a research focus solely on the extraction of sub-categories that exists within non-compliance. Do you agree/disagree? Why?

No disagree. Coz always worth trying to make system better.

3. In general, tax avoidance is legal and tax evasion is illegal. How would you distinguish between the two terms apart from the 'legality' aspect?

In evasion taxpayer lies about the facts. In avoidance taxpayer complies with black letter of law but either does not suffer the economic cost intended to be deducted or retains access to income (in economic terms)

4. What is your view on the improvement that is clearly needed in order to distinguish between (acceptable) tax planning and (unacceptable) tax planning, including (but not limited to tax avoidance and tax evasion)?

As above articulate how the economic substance was ↓

Many up with the Parliamentary reality to the true outcome to be confirmed as not avoidance.

even though in strictly terms they have parted with the income. The tension is always a form / substance tension.

Tax Non-Compliance- Case Law

1. How would you rate the effectiveness of the approaches and principles that are currently being adopted by the judiciary? Please provide some examples.

very good. Ben Nevis, Penny & Hooper & Mexico One have clearly articulated the law & tests. The trouble is that has sucked heaps of tax advisors practices (there has been a drop in business) hence they are cross.

2. The judiciary appears to place an importance on particular approaches and principles (for example, the substance over form approach or the choice principle, are examples of the Parliament's contemplation) when establishing tax avoidance/tax evasion behaviours. How effective would you say this method is? Also, whether changes could be made to improve on the decisions reached in courts?

Very effective. The GAAR uses substance. Economic substance is far more likely to get to the truth than a focus on legal form. We should push economic substance as the guiding principal & all it- ; with.

3. The precedent cases act as 'benchmarks/guidelines' for cases that are presented to court; how would you describe the effectiveness and fairness of this approach when each case is unique and therefore, making them incomparable?

They are clear. They stop heaps of transactions & hence heaps of business for "tax planners" hence the argue in the sector.

4. Some concepts are not defined in legislations but this has not prevented the judiciary to place an area of emphasis on this aspect (for example, the concept of a 'realistic salary level' from Penny and Hooper (Supreme Court, 2011). Would you say this is a workable approach to take by the judiciary?

Yes coz it is a factual inquiry of provable on the facts. Counsel for the taxpayer conceded that the salaries were not at market (which was fiction) but any factual matter is always provable with evidence.

5. In the Dempsey (High Court, 2010) case, there is an impression that there may be 'layers' of tax evasion depending on the severity of the issue where the judiciary may impose a shortened length of imprisonment if the *cause* and *effect* of evading taxes differs between scenarios. That is, as Dempsey did not have the dominant purpose of obtaining a lavishing lifestyle by way of evading taxes, his sentence should not be as long as someone who evaded taxes for the dominant purpose of leading a luxurious lifestyle. What is your view on separating between the 'layers' of tax evasion? Also, whether this is a practical approach for the judiciary to adopt in the future when presented with an evasion-related case?

That happens anyway at sentence.

Over-Compliance

1. The issue of over-compliance (acknowledged within this study as situations where taxpayers have over-paid their share of tax liabilities) has received very little attention from current researchers. Would you consider it an important area of focus for New Zealand given the recent change to the self-assessment regime where it is perceived as an undesirable kind of behaviour for the taxpayers concerned?

Never heard of it.

2. Tax compliance may be considered to be when a taxpayer has met their tax liabilities, whereas, non-compliance may be considered to be when a taxpayer has *under*-met their tax liabilities. Where would you place over-compliance (that is, under the branch of tax compliance or non-compliance)?

tax compliance

3. Despite a number of tax agencies that are able to calculate how much tax refund is owed to a taxpayer for a small fee, what is your view on the IRD's approach and attitude around this area? Would you have expected the IRD to be more pro-active, or believe that their current attitude towards this matter is adequate and acceptable?

IRD can do it if you ask. Can't see the problem.

4. Detected under-compliance may result in penalties and/or imprisonment, but if a wage or salary-based taxpayer is found to have a tax refund due, no credit interest (or equivalent) is paid out to the taxpayers. What is you view on this current approach and whether you think changes within this area is necessary?

I thought credit would be paid to the taxpayer. If not change needed.

End of questions- Thank you.

Appendix F- Letter Sent to the Commissioner of Inland Revenue

College of Business and Economics

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UNIVERSITY OF CANTERBURY
Te Whare Wānanga o Waitaha
CHRISTCHURCH NEW ZEALAND

Robert Russell
Commissioner of Inland Revenue
Inland Revenue Department
PO BOX 39010,
Wellington Mail Centre,
Lower Hutt 5045

10 January, 2012

Dear Mr Russell,

I am currently studying towards a Master of Commerce degree at the University of Canterbury, Christchurch, New Zealand. My thesis is on the topic of behavioural tax compliance and non-compliance primarily from the perspective of taxpayers, but also from the Inland Revenue. The thesis sets out to examine *how* and *why* the definitions for the concepts of tax compliance and non-compliance differ between both existing studies in literature and case law scenarios.

For the purpose of this study, the category of tax compliance underlies the need to differentiate between a taxpayer who complies with the 'letter' of the law against a taxpayer who complies with the 'spirit' of the law. In contrary, the non-compliance category is more complicated as it involves the need for distinction between abusive tax position, tax avoidance, tax evasion, creative compliance, and ultimately over-compliance.

As well as looking at the various definitions available within existing studies and case law, I will also look at the possibility of allocating a 'universal' definition to each of the concepts of tax compliance and non-compliance to enhance the comparability and understandability of future studies in this area. Lastly, this study is set out to evaluate the potential problems that may exist as a result of higher uniformity in the definitions, as well as considering any problems that may arise if definitions cannot be made more consistent between future studies of behavioural tax compliance and non-compliance.

For both tax compliance and non-compliance, several existing studies have emphasized the importance on the need to distinguish between whether a particular behaviour is intentional or unintentional. However, due to the complex nature and the ever-changing environment in taxation, it is often difficult to draw a clear-cut line between intentional/unintentional and legal/illegal behaviours, as demonstrated by taxpayers. As a result, the inconsistencies in the definitions (due to the various approaches taken from existing literature and case law), a great deal of confusion and misunderstanding exists, and therefore, leading to possible non-compliance behaviour without the taxpayers' knowledge and/or intent. As for case law, the emphasis I have placed on them is to determine how tax avoidance behaviour is depicted by the judiciary and whether a 'pre-set standard' is adopted to assess whether tax avoidance and tax evasion is present in each of the case law scenarios.

The main purpose of this letter is three-fold. First, it is intended to seek your views and opinions on the approaches/principles taken by the judiciary in law scenarios when determining whether a particular behaviour is tax avoidance/tax evasion or not. I am aware that to a certain extent, the outcomes of judiciary law scenarios are based upon relevant legislations and precedent cases; however, the intention of this letter is to further gather your views on the suitability of the current approaches and principles being adopted under current judiciary law scenarios, and whether appropriate improvements and/or amendments are necessary. In addition, if the current approaches and principles are deemed adequate in your opinion, what sorts of factors are prompting you to believe that no changes are required in the future? Second, from the various definitions that you would have without a doubt have come across on the concepts of tax compliance and non-compliance, what would be your view on the adequacy or suitability of the definitions that are commonly encountered by taxpayers. In addition, whether you have better suggestions or draft proposals on how the concepts of tax compliance and non-compliance should be defined. Lastly, as it is no longer a legal obligation for wage/salary earners to file annual tax returns, what is your comment on the issue of over-compliance for wage/salary taxpayers who may be 'missing-out' on their tax refunds if they do not have the required knowledge to file a tax return?

Should you have any questions or queries, you are welcome to contact my primary supervisor, Prof. Adrian Sawyer on (03) 3642617.

I look forward to hearing from you soon and thank you for your time and cooperation.

Yours sincerely,

Rebecca Wu

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E-mail: rcw46@uclive.ac.nz